



TENNESSEE ATTORNEY'S TRUST ACCOUNT HANDBOOK

ISSUED BY:

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of the Supreme Court of Tennessee
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DISCLAIMER

This handbook contains legal information, not legal advice. While the Board of Professional Responsibility will make every effort to update the manual as necessary, it is the responsibility of each attorney to ensure that they are following the most current version of the Rules of Professional Conduct.¹ Nothing contained in this handbook is intended to address any specific inquiry, nor is it a substitute for independent legal research to original sources or for obtaining the advice of legal counsel with respect to legal problems.

ACKNOWLEDGEMENTS

Selected portions of this handbook were adopted, adapted, and/or reprinted from the materials originally authored by the following jurisdictions with their permission:

The State Bar of Arizona, *Client Trust Accounting for Arizona Attorneys*, 2014. The workbook may not be reproduced or copied in any manner without the express, written permission of the State Bar of Arizona. (For the current online version of the Arizona Handbook, please go to: <https://azbar.org/media/cldkltly/trust-account-manual-rev-8-2017.pdf>) at *Tennessee Attorney's Trust Account Handbook* Introduction and Sections 1, 5, 8, 9, 10 and 12.

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The State Bar of North Carolina, *Lawyer's Trust Account Handbook*, 2017. (Available online at: <https://www.ncbar.gov/media/283992/trust-account-handbook.pdf>) *Tennessee Attorney Trust Account Handbook*, Sections 3, 4, 6, 7 and 11.

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INTRODUCTION

Trust account.

These two words can send chills up and down the spines of new and experienced lawyers alike. Fear of making a mistake. Fear that you haven't trained your staff well enough. Fear that you don't understand the rules. And besides that, you didn't go to law school to become an accountant, did you?

We put together this handbook to help dispel those fears. We've heard your questions and concerns at seminars and on the Board of Professional Responsibility's ethics hotline. We know the errors that often result in discipline for trust account violations.

Not only does this handbook explain the how-tos of trust accounts but we also explain the whys of trust accounts. We also address a variety of trust-account-related issues.

A couple of general tips as you read this handbook and use it as a resource. First, always remember that it's not your money. That's why it's in a trust account and not your operating account.

Second, your trust account must never have a negative balance. A negative balance means a serious problem.

Third, you should always know to whom the money in your trust account belongs. You can have mystery money in your operating account – *hey, an extra \$100 I didn't realize I had until I balanced the account!* – but not in your trust account. Finally, you must have a detailed paper trail for everything concerning your trust account.

We hope this handbook answers all of your questions – including questions you didn't realize you had until you read it – and provides a guide for accurate and ethical client trust accounting. And you don't even have to be an accountant to get it right.

Section 1 – Trust Account Rules

A. Tenn. Sup. Ct. R. 8, RPC 1.5 – Fees (adopted September 29, 2010; effective January 1, 2011)

(a) A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses. The factors to be considered in determining the reasonableness of a fee include the following:

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

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

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

(4) the amount involved and the results obtained;

(5) the time limitations imposed by the client or by the circumstances;

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

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

(8) whether the fee is fixed or contingent;

(9) prior advertisements or statements by the lawyer with respect to the fees the lawyer charges; and

(10) whether the fee agreement is in writing.

(b) The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation, except when the lawyer will charge a regularly represented client on the same basis or rate. Any changes in the basis or rate of the fee or expenses shall also be communicated to the client.

(c) A fee may be contingent on the outcome of the matter for which the service is rendered, except in a matter in which a contingent fee is prohibited by paragraph (d) or other law. A contingent fee agreement shall be in a writing signed by the client and shall state the method

by which the fee is to be determined, including the percentage or percentages that shall accrue to the lawyer in the event of settlement, trial, or appeal; litigation and other expenses to be deducted from the recovery; and whether such expenses are to be deducted before or after the contingent fee is calculated. The agreement must clearly notify the client of any expenses for which the client will be liable whether or not the client is the prevailing party. Upon conclusion of a contingent fee matter, the lawyer shall provide the client with a written statement stating the outcome of the matter and, if there is a recovery, showing the remittance to the client and the method of its determination.

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

(1) any fee in a domestic relations matter, the payment or amount of which is contingent upon the securing of a divorce or the award of custodial rights, or upon the amount of alimony or support, or the value of a property division or settlement, unless the matter relates solely to the collection of arrearages in alimony or child support or the enforcement of an order dividing the marital estate and the fee arrangement is disclosed to the court; or

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

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

(1) the division is in proportion to the services performed by each lawyer, or each lawyer assumes joint responsibility for the representation;

(2) the client agrees to the arrangement, and the agreement is confirmed in writing; and

(3) the total fee is reasonable.

(f) A fee that is nonrefundable in whole or in part shall be agreed to in a writing, signed by the client, that explains the intent of the parties as to the nature and amount of the nonrefundable fee.

B. Tenn. Sup. Ct. R. 8, RPC 1.15 – Safekeeping Property and Funds (adopted September 29, 2010; effective January 1, 2011)

(a) A lawyer shall hold property and funds of clients or third persons that are in a lawyer's possession in connection with a representation separate from the lawyer's own property and funds.

(b) Funds belonging to clients or third persons shall be deposited in a separate account maintained in an FDIC member depository institution having a deposit-accepting office located in the state where the lawyer's office is situated (or elsewhere with the consent of the client or third person) and which participates in the required overdraft notification program as required by Supreme Court Rule 9, Section 29.1. A lawyer may deposit the lawyer's own funds in such an account for the sole purpose of paying financial institution service charges or fees on that account, but only in an amount reasonably necessary for that purpose. Other property shall be identified as such and appropriately safeguarded. Complete records of such funds and other property shall be kept by the lawyer and shall be preserved for a period of five years after termination of the representation.

(1) Except as provided by subparagraph (b)(2), interest earned on accounts in which the funds of clients or third persons are deposited, less any deduction for financial institution service charges or fees (other than overdraft charges) and intangible taxes collected with respect to the deposited funds, shall belong to the clients or third persons whose funds are deposited, and the lawyer shall have no right or claim to such interest. Overdraft charges shall not be deducted from accrued interest and shall be the responsibility of the lawyer.

(2) A lawyer shall deposit all funds of clients and third persons that are nominal in amount or expected to be held for a short period of time such that the funds cannot earn income for the benefit of the client or third persons in excess of the costs incurred to secure such income in one or more pooled accounts known as an "Interest on Lawyers' Trust Account" ("IOLTA"), in accordance with the requirements of Supreme Court Rule 43. A lawyer shall not deposit funds in any account for the purpose of complying with this sub-section unless the account participates in the IOLTA program under Rule 43.

(3) The determination of whether funds are required to be deposited in an IOLTA account pursuant to subparagraph (b)(2) rests in the sound discretion of the lawyer. No charge of ethical impropriety or other breach of professional conduct shall attend a lawyer's exercise of good faith judgment in making such a determination.

(c) A lawyer shall deposit into a client trust account legal fees and expenses that have been paid in advance, to be withdrawn by the lawyer only as fees are earned or expenses incurred.

(d) Upon receiving funds or other property in which a client or third person has an interest, a lawyer shall promptly notify the client or third person. Except as stated in this Rule or otherwise permitted by law or by agreement with the client, a lawyer shall promptly deliver to the client or third person any funds or other property that the client or third person is

entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding such funds or other property.

(e) When in the course of representation, a lawyer is in possession of property or funds in which two or more persons (one of whom may be the lawyer) claim interests, the property shall be kept separate by the lawyer until the dispute is resolved. The lawyer shall promptly distribute all portions of the property or funds as to which the interests are not in dispute.

C. Tenn. Sup. Ct. R. 9, § 35 Detection and Prevention of Trust Account Violations (adopted August 30, 2013; effective January 1, 2014)

35.1. Maintenance of Trust Funds in Approved Financial Institutions; Overdraft Notification.

(a) Clearly Identified Trust Accounts in Approved Financial Institutions Required.

(1) Attorneys who practice law in Tennessee shall deposit all funds held in trust in this jurisdiction in accounts clearly identified as “trust” or “escrow” accounts, referred to herein as “trust accounts,” and shall take all steps necessary to inform the depository institution of the purpose and identity of the accounts. Funds held in trust include funds held in any fiduciary capacity in connection with a representation, whether as trustee, agent, guardian, executor or otherwise. Attorney trust accounts shall be maintained only in financial institutions approved by the Board, provided however nothing herein shall be construed as limiting any statutory provisions dealing with the investment of trust and/or estate assets, or the investment authority granted in any instrument creating a fiduciary relationship.

(2) Every attorney engaged in the practice of law in Tennessee shall maintain and preserve for a period of at least five years, after final disposition of the underlying matter, the records of the accounts, including checkbooks, canceled checks, check stubs, vouchers, ledgers, journals, closing statements, accounting or other statements of disbursements rendered to clients or other parties with regard to trust funds or similar equivalent records clearly and expressly reflecting the date, amount, source and explanation for all receipts, withdrawals, deliveries and disbursements of the funds or other property of a client. The five year period for preserving records created herein is only intended for the application of this rule and does not alter, change or amend any other requirements for record-keeping as may be required by other laws, statutes or regulations.

(b) Overdraft Notification Agreement and Acknowledgment of Authorization Required.

A financial institution shall be approved as a depository for attorney trust accounts if it files with the Board an acknowledgment of the attorney's constructive consent of disclosure of their trust account financial records as a condition of their admission to practice law, and the financial institution's agreement, in a form provided by the Board to report to the Board whenever any properly payable instrument is presented against an attorney trust account containing insufficient funds, irrespective of whether or not the instrument is honored. The Board shall establish rules governing approval and termination of approved status for financial institutions and shall annually publish a list of approved financial institutions. No trust account shall be maintained in any financial institution that does not acknowledge constructive authorization by the attorney and agree to so report. Any such acknowledgment and agreement shall apply to all branches of the financial institution and shall not be canceled except upon thirty days notice in writing to the Board.

(c) Overdraft Reports. The overdraft notification agreement shall provide that all reports made by the financial institution shall be in the following format:

(1) In the case of a dishonored instrument, the report shall be identical to the overdraft notice customarily forwarded to the depositor, and should include a copy of the dishonored instrument, if such a copy is normally provided to depositors;

(2) In the case of instruments that are presented against insufficient funds but which instruments are honored, the report shall identify the financial institution, the attorney or law firm, the account number, the date of presentation for payment, and the date paid, as well as the amount of overdraft created thereby.

(d) Timing of Reports. Reports under Subpart (c) shall be made simultaneously with, and within the time provided by law for notice of dishonor, if any. If an instrument presented against insufficient funds is honored, then the report shall be made within five banking days of the date of presentation for payment against insufficient funds.

(e) Consent by Attorneys. Every attorney practicing or admitted to practice in this jurisdiction shall, as a condition thereof, be conclusively deemed, under the financial records privacy laws, other similar laws, or otherwise, to have designated the Board as their agent for the purpose of disclosure of financial records by financial institutions relating to their trust accounts; conclusively deemed to have authorized disclosure of financial records relating to their trust accounts to the Board; and, conclusively deemed to have consented to the reporting and production of financial records requirements contemplated or mandated by Sections 35.1 or 35.2 of this Rule.

(f) No Liability Created. Nothing herein shall create or operate as a liability of any kind or nature against any financial institution for any of its actions or omissions in reporting overdrafts or insufficient funds to the Board.

(g) Costs. Nothing herein shall preclude a financial institution from charging a particular attorney or law firm for the reasonable cost of producing the reports and records required by this rule.

(h) Definitions. For the purpose of this Rule:

(1) “Financial institution” includes a bank, savings and loan association, credit union, savings bank, and any other business or person that accepts for deposit funds held in trust by attorneys.

(2) “Properly payable” refers to an instrument which, if presented in the normal course of business, is in a form requiring payment under the laws of this jurisdiction.

(3) “Notice of dishonor” refers to the notice that a financial institution is required to give, under the laws of this jurisdiction, upon presentation of an instrument that the institution dishonors.

35.2. Verification of Bank Accounts.

(a) Generally. Whenever Disciplinary Counsel has probable cause to believe that bank accounts of an attorney that contain, should contain or have contained funds belonging to clients have not been properly maintained or that the funds have not been properly handled, Disciplinary Counsel shall request the approval of the Chair or Vice-Chair of the Board to initiate an investigation for the purpose of verifying the accuracy and integrity of all bank accounts maintained by the attorney. If the Chair or Vice-Chair approves, Disciplinary Counsel shall proceed to verify the accuracy of the bank accounts.

(b) Confidentiality. Investigations, examinations, and verifications shall be conducted so as to preserve the private and confidential nature of the attorney’s records insofar as is consistent with these rules and the attorney-client privilege; however, no assertion of attorney-client privilege or confidentiality will prevent an inspection or audit of a trust account as provided in this Rule.

D. Tenn. Sup. Ct. R. 43 – Interest on Lawyers’ Trust Accounts (amended February 20, 2013, effective *nunc pro tunc* January 1, 2012)

Section 1. The determination of whether or not a financial institution is an eligible institution which meets the requirements of this Rule shall be made by the Tennessee Bar Foundation, the organizational administrator of the IOLTA program. The Foundation shall maintain a list of eligible financial institutions and shall make that list available to Tennessee lawyers. The selection of an institution from the list of those eligible rests with the lawyer or law firm.

Section 2. Eligible institutions are those financial institutions which voluntarily offer IOLTA accounts and comply with the requirements of this Rule, including maintaining IOLTA accounts which pay the highest interest rate or dividend generally available from the institution to its non-IOLTA account customers in a local market area when IOLTA accounts meet or exceed the same minimum balance or other eligibility qualifications, if any. To determine the highest interest rate or dividend generally available from the institution to its non-IOLTA accounts, eligible institutions may consider factors, in addition to the IOLTA account balance, customarily considered when setting interest rates or dividends for customers, provided that such factors do not discriminate between IOLTA accounts and accounts of non-IOLTA customers and that these factors do not include that the account is an IOLTA account. The determination of the highest interest rate or dividend generally available shall not include consideration of promotional rates that are offered by the financial institution for a limited time. Nothing in this Rule shall prohibit an eligible institution from paying an interest rate or dividend higher than required herein.

Section 3. If a financial institution offers one or more of the following product types to its non-IOLTA customers and an IOLTA account qualifies for one or more of the products pursuant to Section 2 of this Rule, then, in order to be an eligible financial institution, the financial institution must pay an interest rate on the IOLTA account equal to the highest yield available at that financial institution among those product types. The financial institution may, at its discretion, either use the identified product or products as the IOLTA account or pay the equivalent yield on the IOLTA account in lieu of using the highest yield bank product(s) identified:

(a) A business checking account with an automated investment feature, such as an overnight investment in repurchase agreements or money market funds fully collateralized by or invested solely in United States government securities which are direct debt obligations of the government of the United States or of agencies or instruments thereof guaranteed by the full faith and credit of the government of the United States as to the payment of principal and interest at maturity; or

(b) A checking account paying preferred interest rates, such as market based or indexed rates; or

(c) A public funds interest-bearing checking account, such as accounts used for governmental agencies and other non-profit organizations; or

(d) An interest-bearing checking account such as a negotiable order of withdrawal (NOW) account, or business checking account with interest; or

(e) A business demand deposit checking interest-bearing transaction account (when permitted by federal law); or

(f) Any other suitable interest-bearing deposit account with or tied to unlimited check writing ability offered by the institution to its non-IOLTA customers.

Section 4. As an alternative to compliance under Section 3, a financial institution may also comply with this rule if it agrees to pay a rate voluntarily negotiated with the Foundation to be in effect for and remain unchanged during a period of up to twelve months as provided pursuant to a voluntary agreement between the financial institution and the Foundation.

Section 5. A daily financial institution repurchase agreement shall be fully collateralized by United States Government Securities, and may be established only with an eligible institution that is "well capitalized" or "adequately capitalized" as those terms are defined by applicable federal statutes and regulations.

Section 6. An open-end money-market fund shall be invested solely in United States Government Securities or repurchase agreements fully collateralized by United States Government Securities and shall hold itself out as a "money market fund" as that term is defined by federal statutes and regulations under the Investment Company Act of 1940 and, at the time of the investment, shall have total assets of at least two hundred fifty million dollars (\$250,000,000).

Section 7. An eligible financial institution participating in the IOLTA program must also:

(a) Remit interest or dividends net of any allowable service charges or fees, preferably monthly, but at least quarterly, to the Tennessee Bar Foundation;

(b) Transmit to the Tennessee Bar Foundation, in a format specified by the Tennessee Bar Foundation, a report which contains:

- (i) the name of the lawyer or law firm on whose account the remittance is sent;
- (ii) the account number;
- (iii) the balance on which the interest rate is applied;
- (iv) the rate of interest or dividends applied;
- (v) the gross interest or dividends earned;
- (vi) the type and amount of any allowable service charges or fees deducted; and
- (vii) the net amount remitted.

A financial institution which maintains more than thirty IOLTA accounts may, at the request of the Tennessee Bar Foundation, be required to transmit the report in an electronic format.

- (c) Transmit information to the lawyer or law firm maintaining that account in accordance with the institution's normal procedures for reporting to depositors.

Section 8. No financial institution service charges or fees may be deducted from the principal of any IOLTA account.

Section 9. Deductions by the financial institution from interest earned may only be for allowable reasonable service charges or fees calculated in accordance with the institution's standard practice for non-IOLTA customers. For purposes of this Rule, "allowable reasonable service charges or fees" are defined as:

- (a) per check or electronic debit charges;
- (b) per deposit or electronic credit charges;
- (c) a fee in lieu of minimum balance;
- (d) FDIC insurance fees or FDIC account guarantee fees;
- (e) a sweep fee; and
- (f) a reasonable IOLTA account administrative fee.

Other financial institution service charges or fees shall not be deducted from IOLTA account interest and shall be the responsibility of, and may be charged to, the lawyer or law firm maintaining the IOLTA account. Nothing in this Rule shall be construed to require that a financial institution charge fees on an IOLTA account, nor does anything in this Rule prohibit a financial institution from waiving or discounting fees associated with an IOLTA account.

Section 10. Allowable reasonable service charges or fees in excess of the interest earned on any one IOLTA account may not be deducted from interest earned on any other IOLTA account.

Section 11. If the Tennessee Bar Foundation, for any reason, determines a financial institution does not meet the requirements of this rule, the Tennessee Bar Foundation will notify the financial institution. The financial institution will be provided not less than thirty days to take corrective action that results in compliance with this rule.

Section 12. A lawyer, law firm or financial institution that objects to a determination of the Tennessee Bar Foundation that a financial institution is not an eligible institution under Section 1 through 10 of this Rule or a lawyer who objects to a determination of the Tennessee Bar Foundation that the lawyer is not eligible for an exemption under Section 14(e), may appeal such determination to the Board of Professional Responsibility in accordance with regulations adopted by the Board of Professional Responsibility.

Section 13. Interest transmitted shall, after deductions for the necessary and reasonable administrative expenses of the Tennessee Bar Foundation for operation of the IOLTA program, be distributed by that entity, in proportions it deems appropriate, for the following purposes:

- (a) To provide legal assistance to the poor;
- (b) To provide student loans, grants, and/or scholarships to deserving law students;
- (c) To improve the administration of justice; and
- (d) For such other programs for the benefit of the public as are specifically approved by the Tennessee Supreme Court.

Section 14. Unless exempt under this Section 14, every lawyer admitted to practice in Tennessee shall certify in the lawyer's annual registration statement required by Tennessee Supreme Court Rule 9, as a condition of licensure, that all funds in the lawyer's possession

that are required pursuant to RPC 1.1 5(b) to be held in an IOLTA account are, in fact, so held and shall list the name(s) of the financial institution(s) and account number(s) where such funds are deposited. This certification shall be made on a form provided by the Board of Professional Responsibility and shall be submitted by the lawyer within the time period set forth in Rule 9 for the annual registration statement. A lawyer licensed in Tennessee is exempt, and shall so certify on the lawyer's annual registration statement, if:

(a) the lawyer is not engaged in the private practice of law in the State of Tennessee;

(b) the lawyer serves as a Judge, Attorney General, Public Defender, U.S. Attorney, District Attorney, in-house counsel, teacher of law, on active duty in the armed forces or employed by state, local or federal government and not otherwise engaged in the private practice of law;

(c) the lawyer does not have an office in Tennessee; however, for purposes of this Rule, a lawyer who practices, as a principal, employee, of counsel, or in any other capacity, with a firm that has an office in Tennessee shall be deemed for purposes of this Rule to have an office in Tennessee if the lawyer utilizes one or more offices of the firm located in Tennessee more than the lawyer utilizes one or more offices of the firm located in any other single state;

(d) under regulations adopted by the Board of Professional Responsibility under criteria established upon recommendation of the Tennessee Bar Foundation, the lawyer or law firm is exempted from maintaining an IOLTA account because such an IOLTA account has not and cannot reasonably be expected to produce interest or dividends in excess of allowable reasonable fees; or

(e) the lawyer is exempted by the Tennessee Bar Foundation from the application of this Rule following a written request for exemption by the lawyer and determination by the Tennessee Bar Foundation that no eligible financial institution (as defined and determined in accordance with this Rule 43) is located within reasonable proximity of that lawyer.

Section 15. As a part of the annual birth month registration process, as provided in Supreme Court Rule 9, the Board of Professional Responsibility shall receive and review a lawyer's certification required by Section 14. In the event a lawyer fails to submit the required certification or should the certification be facially defective, such noncompliance with this Rule will result in the following action:

(a) On or before the 15th day following the date on which the certification required by Section 14 is due, the Board of Professional Responsibility shall serve such lawyer a Notice

of Noncompliance requiring the lawyer to remedy any deficiencies identified in the Notice within 30 days following the mailing of the Notice. Each lawyer to whom a Notice of Noncompliance is issued shall pay to the Board of Professional Responsibility a Noncompliance Fee of One Hundred Dollars (\$100.00). Such Noncompliance Fee shall be paid on or before the 30th day following the mailing of the Notice, unless the lawyer shows to the satisfaction of the Chief Disciplinary Counsel that the Notice of Noncompliance was erroneously issued, in which case no such fee shall be due.

(b) On or before the 30th day following the mailing of the Notice, each lawyer on whom a Notice of Noncompliance is served also shall submit to the Board of Professional Responsibility the lawyer's completed certification. In the event a lawyer fails to timely submit the lawyer certification required by this Rule and payment of the \$100.00 Noncompliance Fee by the 30th day following the mailing of the Notice, the lawyer shall pay to the Board of Professional Responsibility, in addition to the Noncompliance Fee, a Delinquent Compliance Fee of Two Hundred Dollars (\$200.00).

(c) On or before the 45th day following the mailing of each month's Notices of Noncompliance, the Board of Professional Responsibility shall:

(i) prepare a proposed Suspension Order listing all lawyers who were issued Notices of Noncompliance for that month's birth month registration cycle and who failed to remedy timely their deficiencies;

(ii) submit the proposed Suspension Order to the Supreme Court; and

(iii) serve a copy of the proposed Suspension Order on each lawyer named in the Order.

The Supreme Court will review the proposed Suspension Order and enter such order as the Court may deem appropriate suspending the law license of each lawyer deemed by the Court to be not in compliance with the requirements of this Rule.

(d) Each lawyer named in the Suspension Order entered by the Court shall submit to the Board of Professional Responsibility the lawyer certification required by the Rule and shall pay to the Board of Professional Responsibility, in addition to the Noncompliance Fee and the Delinquent Compliance Fee, a Five Hundred Dollar (\$500.00) Suspension Fee as a condition of reinstatement from suspension under subsection (c). Submission of the lawyer certification and payment of all fees imposed by this section shall be a requirement for compliance with this Rule and for reinstatement. Upon satisfaction of this condition of reinstatement, and if the lawyer is otherwise eligible for reinstatement, Chief Disciplinary Counsel will recommend to the Supreme Court that the Court reinstate the lawyer's law

license. No lawyer suspended under this Rule 43 may resume practice until reinstated by Order of the Supreme Court.

(e) Upon receipt of the lawyer's certification required by this Rule and payment of all fees imposed, the Board of Professional Responsibility shall forward the lawyer's completed certification to the Tennessee Bar Foundation.

(f) All notices required or permitted to be served on a lawyer under the provisions of this Rule shall be served by United States Postal Service Certified Mail, return receipt requested, at the preferred address shown in the most recent registration statement filed by the lawyer pursuant to Supreme Court Rule 9 and shall be deemed to have been served as of the postmark date shown on the Certified Mail Receipt.

Section 16. Upon its receipt of a lawyer's certification under Section 14 of this Rule, the Tennessee Bar Foundation shall report monthly to the Board of Professional Responsibility any evidence of the lawyer's noncompliance known by the Tennessee Bar Foundation. Noncompliance with this Rule will result in the following action:

(a) On or before the 15th day following the date the Tennessee Bar Foundation provides its report to the Board of Professional Responsibility, the Board of Professional Responsibility shall serve each such lawyer a Notice of Noncompliance requiring the lawyer to remedy any deficiencies identified in the Notice within 30 days. Each lawyer to whom a Notice of Noncompliance is issued shall pay to the Board of Professional Responsibility a Noncompliance Fee of One Hundred Dollars (\$100.00). Such Noncompliance Fee shall be paid on or before the 30th day following the mailing of the Notice, unless the lawyer shows to the satisfaction of the Chief Disciplinary Counsel that the Notice of Noncompliance was erroneously issued, in which case no such fee shall be due.

(b) On or before the 30th day following the mailing of the Notice, each lawyer on whom a Notice of Noncompliance is served also shall file with the Board of Professional Responsibility an affidavit, in the form specified by the Board of Professional Responsibility, attesting that any identified deficiencies have been remedied. In the event a lawyer fails to timely remedy any such deficiency or fails to timely file such affidavit, the lawyer shall pay to the Board of Professional Responsibility, in addition to the Noncompliance Fee, a Delinquent Compliance Fee of Two Hundred Dollars (\$200.00).

(c) On or before the 45th day following the mailing of each month's Notices of Noncompliance, the Board of Professional Responsibility shall:

(i) prepare a proposed Suspension Order listing all lawyers who were issued Notices of Noncompliance for that month's birth month registration cycle and who failed to remedy timely their deficiencies;

(ii) submit the proposed Suspension Order to the Supreme Court; and

(iii) serve a copy of the proposed Suspension Order on each lawyer named in the Order.

(d) The Supreme Court will review the proposed Suspension Order and enter such order as the Court may deem appropriate suspending the law license of each lawyer deemed by the Court to be not in compliance with the requirements of this Rule.

(e) Each lawyer named in the Suspension Order entered by the Court shall file with the Board of Professional Responsibility an affidavit in the form specified by the Board of Professional Responsibility, attesting that any identified deficiencies have been remedied and shall pay to the Board of Professional Responsibility, in addition to the Noncompliance Fee and the Delinquent Compliance Fee, a Five Hundred Dollar (\$500.00) Suspension Fee as a condition of reinstatement from suspension under subsection (d). Payment of all fees imposed by this section shall be a requirement for compliance with this Rule and for reinstatement. Upon satisfaction of this condition of reinstatement, and if the lawyer is otherwise eligible for reinstatement, Chief Disciplinary Counsel will recommend to the Supreme Court that the Court reinstate the lawyer's law license. No lawyer suspended under this Rule 43 may resume practice until reinstated by Order of the Supreme Court.

(f) All notices required or permitted to be served on a lawyer under the provisions of this Rule shall be served by United States Postal Service Certified Mail, return receipt requested, at the preferred address shown in the most recent registration statement filed by the lawyer pursuant to Supreme Court Rule 9 and shall be deemed to have been served as of the postmark date shown on the Certified Mail Receipt.

Section 17. The information contained in the statements forwarded to the Tennessee Bar Foundation under Section 14 and/or Section 15 of this Rule shall remain confidential other than as to Tennessee Supreme Court or the Board of Professional Responsibility. The Tennessee Bar Foundation shall not release any information contained in such statements other than as a compilation of data from such statements, except as directed in writing by the Tennessee Supreme Court or the Board of Professional Responsibility or in response to a subpoena.

Section 2 – The Importance of Client Trust Accounting

If you became disabled or died suddenly, would your clients — or the personal representatives of your estate — be able to tell how much of the money in your client trust account belonged to each client? If a Disciplinary Counsel for the Board asked you to account for a particular client’s money, would you be able to do so? Would the Disciplinary Counsel find complete, systematic, up-to-date records showing what’s been received and paid out for each client, or would the Disciplinary Counsel find a random assortment of canceled checks, unopened bank statements, and general ledgers/checkbook registers full of cryptic notations and rounded-off figures? In these situations, the fact that you “have it all in your head” isn’t going to help your clients find their money or satisfy the Board of Professional Responsibility.

There are two completely mistaken preconceptions about client trust accounting. One is that client trust accounting is a mysterious, complicated process that requires years of training and innate mathematical ability. The other is that “maintaining a client trust account” simply means opening a bank account and depositing clients’ funds into it.

The truth is that client trust accounting consists of a simple set of easy-to-learn and easy-to-use procedures that require consistent, careful application. But as simple as it is, client trust accounting still means more than keeping money in the bank. A bank account is something you have; client trust accounting is something you do in order to know—and to show your clients that you know—how much of the money in your account belongs to each client.

Whether you find it easy or difficult, the fact is that if you agree to hold money in trust, you take on a non-delegable, personal fiduciary responsibility to account for every penny as long as the funds remain in your possession. This responsibility can’t be transferred, and isn’t excused by your or your employees’ ignorance, inattention, incompetence or dishonesty. The legal and ethical obligation to account for those monies is yours and yours alone, regardless of how busy your practice is or how hopeless you are with numbers. You may employ others to help you fulfill this duty, but if you do, you must provide adequate training and supervision as required by RPC 5.3. Failure to live up to this responsibility can result in personal monetary liability, fee disputes, loss of clients and public discipline.

The essence of client trust accounting is contained in those three words:

Client (These duties arise in the context of an lawyer-client relationship, regardless of whether you are paid for your services, and are as inviolable as your duty to maintain client confidences. These duties may also be owed to third parties.)

Trust (The willingness of people to trust a complete stranger with money just because the stranger is a lawyer is a fundamental aspect of the lawyer-client relationship, and maintaining that trust is the duty of every individual lawyer and a matter of supreme public interest.)

Accounting (The way to fulfill your clients' trust is to be able, at any time, to make a full and accurate accounting of all money you've received, held and paid out on their behalf.)

That's all "client trust accounting" means. If you follow the simple procedures explained below, you will never have to worry about failing to live up to your duties as a fiduciary no matter how complex or busy your practice is.

Imagine how you'd feel if you asked your bank how much money was in your personal account, and the bank officer explained that the bank couldn't tell you because business was booming and keeping exact records of so much money for so many people would just take too much time. You'd probably feel that if knowing how much of your money it held was too much trouble, the bank shouldn't be holding your money. That's exactly how your clients feel about you. You keep records so you can give your clients an accounting of their money; failing to do so is a violation of your professional responsibilities.

The minute you don't keep track of a client's money, you violate the client trust accounting rules. The longer you don't know, the more violations you're likely to stumble into, and if you keep stumbling, sooner or later you're going to stumble into a Board of Professional Responsibility investigation.

And don't think if you keep enough of your own money in the client trust account that everything's all right. Not only does that not satisfy your professional responsibility to your clients, it may also constitute an additional violation known as "commingling." In short, the only adequate way to fulfill your fiduciary responsibility to your clients is to keep track of how much of their money you have in your client trust account, at all times.

You must maintain a ledger, or the equivalent, for each client that reflects all transactions related to that client's funds, even if you hold money only long enough for the check to clear then disburse and close the matter. If you hold administrative funds to cover the costs of maintaining the account, you also must create a ledger or equivalent for those administrative funds.

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

Pointers for everyday trust account management

- Do not sign blank trust account checks. If you do, you risk someone using them for improper purposes.
- Do not allow your staff to use a signature stamp. If you do, you risk someone endorsing checks for improper purposes.
- Receive trust account bank statements unopened or sent directly to you by electronic transmission. You can then review the statement before someone could tamper with it.
- Checks on the trust account should never be made payable to “cash.” Checks from the trust account should never be used for the lawyer’s personal expenses.
- If you delegate duties, do not allow the same person to handle everything to do with the trust account. The person who takes in the deposits should not be the same person who writes the checks on the account.
- Use different colored checkbook covers for your trust account and your operating account so as not to confuse the two when you are in a hurry.
- DO NOT carry your trust account checkbook with you when you leave your office. Many lawyers have written checks for inappropriate disbursements from the trust account “because it was the only checkbook I had with me.” The only exception may be when you are making a trip specifically to disburse funds (such as a filing fee) on behalf of the client, but you do not know the exact amount. Before leaving the office, make sure you know exactly how much money is available for that particular client (the checkbook alone will not give you that information if you have money in the account for more than one client) and do not exceed that amount.
- Include in your fee agreement information about how fees will be handled, including money paid in advance for fees or costs and expenses. It’s also a good idea to provide your client with an itemized statement of work performed prior to transferring fees that you consider earned. If the client disputes the amount, you will need to hold it in the trust account pending resolution.
- Develop and memorialize a standard procedure for notifying clients or third parties when you receive funds in which they have an interest and take steps to assure that you consistently follow the procedure. Be sure part of the procedure is documenting notice to

the client. If it's done by telephone call rather than in writing, be sure to include details of when the call was made and with whom the caller spoke.

- If support staff helps you maintain your trust account, you **MUST** properly train and supervise them; no matter how long they've been in your employment and no matter how well you believe they understand trust account requirements. Be sure you understand the process well enough and periodically audit whether it's being handled properly.
- Do not set up overdraft protection or a credit line on your trust account. This will be considered commingling of your personal funds if either takes effect.

Section 3: Key Concepts in Client Trust Accounting

The following seven key concepts provide the background you need to understand your client trust accounting responsibilities.

Key Concept 1: Separate Clients Are Separate Accounts

Client A's money has nothing to do with Client B's money. Even when you keep them in a general trust account (also known as an IOLTA account), each client's funds are completely separate from those of all your other clients. In other words, you are NEVER allowed to use one client's money to pay another client's or your own obligations.

In a general trust account, the way to distinguish one client's money from another's is to keep a client ledger of each individual client's funds. A client ledger tells you how much money you've received on behalf of a client, how much money you've paid out on behalf of that client, and how much money that client has left in your general trust account. If you are holding money in your general trust account for 10 clients, you have to maintain 10 separate client ledgers. If you keep each client's ledger properly, you will always know exactly how much of the money in your general trust account belongs to each client. If you don't, you will lose track of how much money each client has, and when you make payments out of your general trust account, you won't know which client's money you are using.

Also note, if your client's money can earn income because the funds are large enough in amount or are held for a long period of time, then you should consider whether to place the funds in your general trust account or a separate trust account for that client or transaction. RPC 1.15(b)(c).

Key Concept 2: You Can't Spend What You Don't Have

Each client has only his or her own funds available to cover their expenses, no matter how much money belonging to other clients is in your general trust account. Your general trust account might have a balance of \$100,000, but if you are only holding \$10.00 for a certain client, you can't write a check for \$10.50 on behalf of that client without using some other client's money. The following example graphically illustrates this concept. Assume you are holding a total of \$5,000 for four clients in your general trust account as follows:

Client A	\$1,000
Client B	\$2,000
Client C	\$1,500
<u>Client D</u>	<u>\$ 500</u>
Total	\$5,000

If you write a check for \$1,500 from the general trust account for Client D, \$1,000 of that check is going to be paid for by Clients A, B and C. The funds you are holding in trust for them are being used for Client D's expenses. You should have a total of \$4,500 for Clients A, B and C, but you only have \$3,500 left in the trust account. In disciplinary matters, the failure to maintain a sufficient client trust account balance will support a finding of misappropriation.

Key Concept 3: There's No Such Thing as a “Negative Balance”

It's not uncommon in personal checkbooks for people to write checks against money they haven't deposited yet or a check that has not cleared yet, and show this as a “negative balance.” In client trust accounting, there's no such thing as a negative balance. A “negative balance” is at best a sign of negligence and, at worst, a sign of theft.

In client trust accounting, there are only three possibilities:

- You have a positive balance (while you are holding money for a client);
- You have a zero balance (when all the client's money has been paid out); or
- YOU HAVE A PROBLEM because the balance is less than zero (a so-called “negative balance”).

Key Concept 4: Timing Is Everything

It takes anywhere from a day to several weeks after you make a deposit before the money becomes “available for use.” A client's funds aren't “available” for you to use on the client's behalf until they have cleared the banking process and been credited by the bank to your general trust account. (This is especially true when you receive an insurance company's settlement draft — which cannot clear until the company actually receives the draft at its home office during the bank collection process and honors the draft. Thus, insurance company settlement drafts will take longer to clear your account.) If you write a check for a client at any time before that client's funds clear the banking process and are credited to your general trust account, ordinarily either the check will bounce or you will be using other clients' money to cover the check.

The time it takes for trust account funds to become available after deposit depends on the form in which you deposit them. Every bank has different procedures, so when you open your trust account, get the bank's schedule of when funds are available for withdrawal. Depending on the instrument, you may have to wait as many as 15 working days before you can be reasonably confident that the funds are available. For example, even if you make a cash deposit, the money may not be available for use until the following day. If you deposit a personal check from an out-

of-state bank, the money will take longer to be available. Either way, until the bank has credited a deposit to your general trust account, you can't pay out any portion of that money for that client.

You also need to know what time your bank has set as the deadline for posting deposits to that day's business and for paying checks presented to it. Otherwise, even when you have deposited cash, you may end up drawing on uncollected funds. For example, let's say your bank credits any deposit made after 3 p.m. on the following day, but stays open for business until 5 p.m. Your client arrives at 3:30 and gives you \$5,000 in cash which you immediately deposit. At 4 p.m., you write a general trust account check against that money to pay an investigator. If the investigator presents the check for payment at the bank before it closes at 5 p.m., the check will either bounce or be covered by other clients' money.

You may be tempted to do your client a favor by writing a check from your trust account to the client for settlement proceeds before the settlement check has cleared because you know there's money belonging to other clients in your general trust account to cover this client's check. Depending on the circumstances, your client may insist that you do this. Don't. If you do, you'll end up writing a check to one client using another clients' money. You should never help one client at the expense of your obligations to your other clients. In other words, no matter how expedient or kind or convenient it seems, don't make payments on your clients' behalf before their deposited funds have cleared. Otherwise, sooner or later, you'll end up spending money your clients don't have.

Key Concept 5: You Can't Play the Game Unless You Know the Score

In client trust accounting, there are two kinds of balances: the “running balance” of the money you are holding for each client, and the “running balance” of the general trust account.

A “running balance” is the amount you have in an account after you add in all the deposits (including interest earned, etc.) and subtract all the money paid out (including bank charges for items like wire transfers, etc.). In other words, the running balance is what's in the account at any given time. The running balance for each client is kept on the client ledger, and the running balance for each trust account is kept on the account journal.

Maintaining a running balance for a client is simple. Every time you make a deposit on behalf of a client, you write the amount of the deposit in the client ledger and add it to the previous balance. Every time you make a payment on behalf of the client, you write the amount in the client ledger and subtract it from the previous balance. The result is the running balance. That's how much money the client has left to spend.

You figure out the running balance for the general trust account the same way. Every time you make a deposit to the general trust account, you write the amount of the deposit in the account journal and add it to the previous balance. Every time you make a payment from the general trust account, you write the amount in the account journal and subtract it from the previous balance. The result is the running balance. That's how much money is in the account.

Since “you can't spend what you don't have,” you should check the running balance in each client's ledger before you write any general trust account checks for that client. That way, if your records are accurate and up to date, it's almost impossible to pay out more money than the client has in the account.

Key Concept 6: The Final Score Is Always Zero

The goal in client trust accounting is to make sure that every dollar you receive on behalf of a client is ultimately paid out to the client at the conclusion of the representation or to third parties on the client's behalf. What comes in for each client must equal what goes out for that client; no more, no less.

Many lawyers have small, inactive balances in their general trust accounts. Sometimes these balances are the result of a mathematical error, sometimes they are part of a fee you forgot to take, and sometimes a check you wrote never cleared or wasn't cashed.

Whatever the reason, as long as the money is in your general trust account, you are responsible for it. The longer these funds stay in the bank, the harder it is to account for them. Therefore, you should take care of those small, inactive balances as soon as possible, including, if necessary, following up with payees to find out why a check hasn't cleared.

If you take steps to take care of these small balances and are still unable to pay out the funds, you should consider whether the unclaimed monies must be escheated to the state. For more information on abandoned or unclaimed funds, see Section 4, Part D, “Abandoned or Unclaimed Funds/Property.”

Key Concept 7: Always Maintain an Audit Trail

An “audit trail” is the series of bank-created records, like cancelled checks, bank statements, etc., that make it possible to trace what happened to the money you handled. An audit trail should start whenever you receive funds on behalf of a client and should continue through the final check you

issue against them. Without an audit trail, you have no way to show that you have taken proper care of your clients' money, or to explain what you did with the money if any questions come up. The audit trail is also an important tool for tracking down accounting errors. If you don't maintain an audit trail, you will find it hard to correct the small mistakes, like errors in addition or subtraction, and the big mistakes, like miscredited deposits, that are inevitable when you handle money.

The key to making a good audit trail is being descriptive. Let's say you are filling out a deposit slip for five checks relating to three separate clients. All the bank requires you to do is write down the bank identification code for each check and the check amounts. This doesn't identify which client the money belongs to. If you include the name of the client and keep a copy or make a duplicate, you will know which client the check was for, which is the purpose of an audit trail. That will make it easy to answer any questions that come up, even years later.

By the same token, every check you write from your general trust account should include the name of the client on whose behalf it is written, so that it is easy to match up the money with the client. That means you should **NEVER** make out a general trust account check to cash, because there is no way to know later who actually cashed the check. If you are handling more than one case for the client, indicate which matter the payments and receipts relate to on your checks and deposit slips.

Section 4: Trust Account Basics

A. Trust Accounts: What are they and how many do you need?

What is a trust account?

A trust account is a bank account maintained incident to a lawyer's law practice in which the lawyer holds funds received in a fiduciary capacity on behalf of or belonging to a client or third person.

Who must have a trust account?

Any lawyer who receives funds in a fiduciary capacity in the context of his or her law practice must have access to or maintain a trust account. The lawyer must have access to or establish a trust account before receiving such funds. See RPC 1.15(a), (b), and (c). Lawyers who do not receive funds belonging to or on behalf of clients do not have to have a trust account.

How many trust accounts does a lawyer need?

Generally speaking, a lawyer needs only one trust account to handle monies received in trust which are either nominal in amount or held for a short period of time. Within this common account—called a "general trust account"—the funds of many clients may be commingled so long as adequate records are kept to identify the funds of each client. See RPC 1.15(b)(2). If desired, a lawyer may have multiple trust accounts for administrative purposes. For example, lawyers often have trust accounts for real estate transactions which are distinct from the trust accounts used for other client matters.

Does each lawyer in a firm need a separate trust account?

No. Each lawyer in a firm may ethically use the firm's general trust account so long as adequate records of the funds of each client are maintained. However, multiple accounts are permissible. A lawyer may personally maintain several trust accounts if he or she desires.

Is a lawyer ever permitted to establish a trust account for one client, one transaction, or a series of integrated transactions?

Yes. The size of the deposit or the length of time the deposited funds are to be held could be such that a prudent person acting in a fiduciary capacity would be expected to invest the funds on behalf of the beneficiary, and a lawyer receiving funds under such circumstances would have a corresponding right to deposit the funds in a separate interest-bearing or dedicated trust account.

RPC 1.15(b)(1)(3). Comment [5] following RPC 1.15 contains a list of factors to be considered when determining whether there is a duty to deposit funds into a separate interest-bearing dedicated trust account. Any interest generated is the property of the client.

What sort of bank account must be maintained?

A lawyer has an ethical obligation to pay or deliver client funds promptly as instructed by the client, unless there is a dispute about the funds in which case the funds should be kept separate until the dispute is resolved. See RPC 1.15(d)(e) and Formal Ethics Opinion 2010-F-154. The determination of whether funds are required to be deposited in an IOLTA account rests in the sound discretion of the lawyer. See RPC 1.15(b)(3).

B. Opening a Trust Account

1. Choosing a Trust Account Bank

RPC 1.15 of the Tennessee Rules of Professional Conduct, contains many provisions about the duty to deposit client funds in a trust account to protect and secure the funds. For example, RPC 1.15(b) admonishes:

Funds belonging to clients or third persons shall be deposited in a separate account maintained in an FDIC member depository institution having a deposit-accepting office located in the state where the lawyer's office is situated (or elsewhere with the consent of the client or third person) and which participates in the required overdraft notification program as required by Supreme Court Rule 9 § 35.

The rule says a lawyer shall deposit funds in a separate account located in the state where the lawyer's office is situated or elsewhere with the consent of the client or third person.

The depository bank for a lawyer's trust account must agree to the following:

- Report to the Board of Professional Responsibility when an item drawn on the trust account is presented for payment against insufficient funds. See Rule 9 § 35. A lawyer may not maintain a trust or fiduciary account at a bank that does not agree to make the reports.

- Agree to pay IOLTA accounts the highest interest rate available to that bank's other customers when the IOLTA accounts meet the same minimum balance or other account qualifications (also known as the "comparability requirement"). See Rule 43 § 2. Banks will be certified as "eligible" by the Tennessee Bar Foundation upon a finding that they are in compliance with this comparability requirement, and the Board of Professional Responsibility will maintain a list of eligible banks. Banks not found on the eligible list

must submit an Overdraft Notification Agreement and receive approval before IOLTA accounts may be opened with them.

If your bank is not doing these things, you are professionally responsible—not the bank. Compliance with the requirements varies substantially from bank to bank and from branch office to branch office. Some banks regularly fail to notify the Board of Professional Responsibility when a trust account check is presented against insufficient funds. This occurs despite the bank's agreement to notify the Board of Professional Responsibility of an overdraft.

How Do You Fulfill Your Professional Responsibility to Choose the Right Bank?

Since you are responsible, the only way for you to act in a professionally responsible manner is to investigate the banks in your community to find out which banks understand the requirements and are willing to comply. If a local branch manager does not understand the notice and recordkeeping rules, or the IOLTA comparability requirement, encourage the manager to contact the home office for instructions or call the Board of Professional Responsibility and/or the Tennessee Bar Foundation. Disciplinary Counsel and/or staff for these agencies would be glad to explain the rules and requirements.

Are there restrictions concerning the kinds of institutions where trust accounts may be maintained?

Yes. Trust accounts may only be maintained at FDIC member depository institutions having a deposit-accepting office located in the state where the lawyer's office is situated. See RPC 1.15(b). Dedicated trust accounts may be maintained at an institution outside the state upon consent of the client or third person.

2. Opening a Client Trust Account

Labeling a Trust Account

A trust account must be clearly labeled and designated as a "trust account," and all checks drawn on the account must be so identified. For instance, an appropriate title for a general trust account might be "The Trust Account of John Smith, Lawyer" or "Smith, Jones & Williams Trust Account."

Each account in which funds are held by a lawyer pursuant to the lawyer's service as a trustee, guardian, personal representative, attorney-in-fact, or escrow agent must be appropriately labeled as a fiduciary account unless such funds are held in a general trust account. For example, an appropriate title for a fiduciary account might be "Trust Account for the Estate of John Doe."

Similarly, a dedicated trust account that holds the funds of one client must be properly labeled as a trust account (e.g., "Trust Account for the Benefit of Jane Smith").

Trust Account Checks

Any check written from the trust account should have client reference data on the check. The client's name or identification number may appear on the check stub, check register, journal, etc.; however, this information should also appear on the check. If a trust account software program or a check-writing program cannot record this reference data on the check, it should be manually recorded.

If a check drawn on the trust account includes payment of fees or cost reimbursement for more than one client, the check should indicate the respective individual payments. The purpose for the disbursement may be indicated after the client's name (i.e., fees, cost reimbursement, etc.).

C. Trust Account Management

May the responsibility for managing a firm's trust accounts be delegated to one lawyer in a firm?

Yes, however, all managing lawyers in the firm may be professionally responsible for violations of the trust accounting rules that result from failure to have in effect procedures that the rules will be followed. RPC 5.1.

May a lawyer delegate the management of a trust account, including check signing authority, to a staff member who is not a lawyer?

Yes, however, the lawyer is professionally responsible for the supervision of the non-lawyer. RPC 5.3 and RPC 8.4(a). A lawyer may be subject to professional discipline for violations of the trust accounting rules that result from the inadequate supervision of a staff member.

D. Abandoned or Unidentified Funds/Property

If a lawyer holds funds in a general trust account and does not know either the identity or the location of the owner of those funds, what should be done with the money?

The lawyer must first make a diligent attempt to determine the identity and/or the location of the owner of the funds in order that an appropriate disbursement might be made. This means questioning personnel and investigating records and other sources of information in an effort to determine the identity and location of the owner of the funds. If that effort is successful, the

entrusted property shall be promptly transferred to the person or entity to whom it belongs. If the lawyer is unsuccessful in ascertaining the identity or the location of the owner of the funds, the lawyer after 12 months of the discovery of the unidentified funds, must remit the funds to the Tennessee Lawyers' Fund for Client Protection. See RPC 1.15(f). Funds that qualify for escheatment to the State of Tennessee pursuant to T.C.A. 66-29-101 to 66-29-204 (Uniform Disposition of Unclaimed Property Act) should be remitted pursuant to that statute. Pending escheatment, the funds should be held and accounted for in the lawyer's trust account.

E. Closing a Trust Account

1. Closing account with remaining funds

I have a trust account I no longer use, but some funds remain in the account. How do I close the account?

Either transfer the funds from the old account into a new account or disburse the funds to the owners as shown on the client ledgers for the account. See RPC 1.15. Any funds on deposit for a client who is no longer represented by the lawyer or the law firm should be disbursed to the owners thereof. If transfer to a new account is appropriate, you must document the transfer of the funds from the old account to the new account and accurately note the deposit of funds on the appropriate clients' ledgers. See Rule 1.15. If any interest was credited to the dormant account, this money should be sent to the IOLTA program. If there are unclaimed or unidentified funds in the account, see the discussion of abandoned funds in the preceding pages.

Section 5: Fees

Why is it important in a manual on client trust accounting to discuss what kind of fees you accept? Because the characterization of the fee – and, in reality, how you apply it to the client’s work – determines whether you put the fee in your IOLTA account or your operating account.

Any funds received by a lawyer can be analyzed by the basic test of “To whom does this money belong right now?” If the answer is “the lawyer,” the funds should be deposited to an operating account. If the answer is “the client” (or a third party related to the representation), the funds should be deposited to the trust account. If it belongs in part to the lawyer and in part to the client or third party, it must first be deposited into the trust account. The part belonging to the lawyer should be removed once the funds have been earned. The best management procedure is to clearly define in a written fee agreement to whom the money belongs, where it will be deposited and when and how it will be used.

A. Advanced Fee/Retainer

Except for a nonrefundable fee as discussed below, an advanced fee is an amount paid to a lawyer in contemplation of future services that will be earned at an agreed-upon basis, whether hourly or flat. Any amount paid to a lawyer in contemplation of future services is an advanced fee regardless of what the fee is called. An advanced fee must be deposited into the client trust account. Formal Ethics Opinions 92-F-128; 92-F-128(a) and 92-F-128(b) and RPC 1.5(f).

B. Flat Fee

A flat fee is a fixed amount paid to a lawyer for specific, agreed-upon services, or for a fixed, agreed-upon stage in a representation, regardless of the time required of the lawyer to perform the service or reach the agreed-upon stage in the representation. A flat fee is not an advance against the lawyer’s hourly rate and may not be billed against at an hourly rate. A flat fee may or may not be paid in advance but is not deemed earned until the work is performed.

C. Nonrefundable Fee

A nonrefundable fee or earned-upon-receipt fee is a flat fee paid in advance that is deemed earned upon payment regardless of the amount of future work performed. The agreement as to when a fee is earned determines whether it must be deposited to the client trust account and may have significance under other laws such as tax and bankruptcy. If a flat fee is not designated earned-upon-receipt, then it is presumed to belong to the client and it must be deposited in the trust account. Formal Ethics Opinions 92-F-128; 92-F-128(a) and 92-F-128(b). A fee that is nonrefundable in whole or in part shall be agreed to in a writing, signed by the client, that explains

the intent of the parties as to the nature and amount of the nonrefundable fee. RPC 1.5(f). Nonrefundable fees are subject to the reasonableness standard in RPC 1.5(a). RPC 1.5 Comment [4a]. Nonrefundable fees are earned fees so long as the lawyer remains available to provide the services called for by the retainer or for which the fixed fee was charged. RPC 1.5 Comment [4a].

If the initial payment is defined as a nonrefundable fee that will be paid for the lawyer's availability (including the potential necessity for the lawyer to decline representation of other clients), whether or not his or her services are actually used, the fee generally belongs to the lawyer upon receipt and should be deposited into an operating account.

D. Contingent Fees

RPC 1.5(c) requires that contingent fee agreement be in writing and signed by the client. The agreement must state the method by which fee is to be determined, including the percentage that lawyer receives if settlement, trial or appeal, and whether the expenses will be deducted from the recovery before or after fee is calculated. Upon conclusion of matter the lawyer must provide the client with a written statement stating the outcome, the remittance to client (if any), and the method of determining any remittance. This written statement is not a substitute for a client ledger. A lawyer may require advance payment of a fee, but may be obliged to return any unearned portion. RPC 1.5 Comment [4] and Comment [4a] referencing RPC 1.16(d).

E. Advanced Costs

All advanced payments of costs must be held in trust until the costs are incurred. If a lawyer receives an advanced payment that includes both fees and costs, the lawyer must deposit that payment into the trust account.

F. Refunds

The reasonableness requirement and application of the factors to be considered may mean that a client is entitled to a refund of an advance fee payment even though it has been denominated "nonrefundable" "earned upon receipt" or in similar terms that imply the client would never become entitled to a refund. So that a client is not misled by the use of such terms, RPC 1.5 requires that a lawyer make certain minimum disclosures to the client in writing. See RPC 1.5(f). This does not mean the client will always be entitled to a refund upon early termination of the representation nor does it determine how any refund should be calculated but merely requires and agrees to the non-refundable fee and the amount of this fee. Nonrefundable fees are earned fees so long as the lawyer remains available to provide the services called for by the retainer or for which the fixed fee was charged. RPC 1.5 comment [4a]. Lawyers should keep time records for all representations,

even flat-fee arrangements and contingency cases, so they can use this information if they need to demonstrate the reasonableness of the fee in case the client terminates representation early.

A lawyer who is discharged by a client, or withdraws from representation of a client, shall, to the extent reasonable practicable, take steps to protect the client's interests. Depending on the circumstances, protecting the client's interests may include...promptly refunding any advance payment of fees that have not been earned or expenses that have not been incurred. RPC 1.16(d)(6).

Section 6: Funds Go In

A. What Goes Into a Trust Account?

The general rule is that every receipt of money from a client or for a client which will be used or delivered on the client's behalf should be placed in the trust account or a fiduciary account if the funds are received by a lawyer while serving as a lawyer or other professional fiduciary. This includes funds received by the lawyer as an escrow agent. *See RPC 1.15(b) and (c), and Comment [10].*

Must a lawyer deposit very small sums of money received from a client into a trust account?

Yes. A lawyer who receives from his or her client a small sum of money (for example, money which is to be used to pay the cost of recording a deed) must deposit that money in a trust account.

May a lawyer who receives a lump sum payment in advance, which is inclusive of the costs of litigation, deposit the payment in his operating account as fees?

No. Where a lawyer receives a lump sum payment in advance which is inclusive of the costs of litigation, the portion representing the costs must be deposited in the trust account. Some of the money collected by the firm as “fees” is actually entrusted funds intended to defray the costs of litigation. The rules require that funds received in the fiduciary capacity, however characterized, be directly deposited into a trust account.

B. What Does Not Go in the Trust Account?

May a lawyer deposit his or her own funds in a trust account?

No funds belonging to the lawyer may be deposited in the trust account except such funds as are necessary to open or maintain the account, or pay service charges, or are funds belonging in part to a client and in part presently or potentially to the lawyer, such as where a deposited item represents both the client's recovery and the lawyer's fee. In such a case, the portion of the funds belonging to the lawyer must be withdrawn from the trust account as soon as the lawyer becomes entitled to the funds unless the right of the lawyer to receive that portion is disputed by the client in which event the disputed portion must remain in the trust account until the dispute is resolved. See RPC 1.15(b).

Should nonrefundable retainers pursuant to RPC 1.5(f) be deposited in the trust account?

Strictly speaking, no. Since a nonrefundable retainer is deemed earned when paid, it immediately becomes the property of the lawyer and as such must not be deposited in the trust account. Nonrefundable retainers must be distinguished from fees paid in advance which are intended to be held by the lawyer as security deposits against work which is yet to be performed. A lawyer has an ethical obligation to refund the unearned portion of any fee paid in advance upon discharge or withdrawal, therefore, such funds are not considered property of the lawyer and must be held in

the trust account until they are earned. RPC 1.15, RPC 1.16(d), and Formal Ethics Opinion 92-F-128; 92-F-128(a); and 92-F-128(b).

C. Depositing Funds into a Trust Account

1. Example: Depositing a Mix of Trust and Non-trust Funds

A lawyer advises a client that a domestic matter will involve a legal fee of \$150.00, earned upon receipt, as agreed up front, a recording fee of \$30.00, and a sheriff fee of \$4.00, totaling \$184.00.

Alternative (a): The client presents the lawyer with a check for \$184.00. The check is deposited into the general trust account. A check for \$150.00 is then disbursed to the lawyer and the remaining fees are paid when required (RPC 1.15).

Alternative (b): The client pays with two checks, one for \$150.00 and another for \$34.00. The \$34.00 check is deposited into the general trust account. The \$150.00 is deposited in the firm operation account or otherwise paid to the lawyer.

Alternative (c): The client pays in cash. Thirty-four dollars (\$34.00) is deposited into the general trust account. The remaining cash is deposited in the firm operating account or otherwise paid to the lawyer.

If the lawyer previously advanced the recording and sheriff fees, all funds received from the client would in each instance be deposited into the operating account.

If, however, a check submitted by a client contains any funds that are to be used to pay client expenses in the future, the check must be deposited into the trust account intact.

2. Credit Card Payments from Clients

Lawyers may accept payment of legal fees by electronic transfer and credit card. Client funds cannot be deposited by credit card to the office operating account and then transferred to the trust account. A lawyer must arrange to have all credit card payments deposited into the trust account if the lawyer's bank cannot or will not distinguish between the operating account, into which earned fees are deposited, and the trust account, into which unearned fees and entrusted funds are deposited.

3. Cash Reimbursements

RPC 1.15 requires client funds to be promptly deposited in a lawyer trust account and RPC 1.15 requires a lawyer to maintain a complete record of all client funds received by the lawyer. Therefore, cash refunds must be recorded on the client's ledger card and deposited in the trust account.

Section 7: Funds Go Out

A. What Disbursements are Inappropriate?

1. Immediate Disbursement

Disbursement against a client check should not be made until the check is collected unless the lawyer's depository bank grants provisional credit for deposited items. The risk that a check will not clear may not be borne by other client funds in the trust account.

Trust account checks are returned for insufficient funds on occasion because of the failure to make a deposit before the close of the banking day (usually 2:00 P.M.). Such deposits are not posted until the following business day. Timely deposits ensure availability of funds for disbursement.

2. Bank Charges

Some lawyers inadvertently pay the bank service charges for check printing, wires, returned checks, etc., from client funds. This occurs when a bank debits the trust account for a service charge. RPC 1.15(b) permits a lawyer to deposit in advance sufficient personal funds in the trust account to pay for service charges, thereby avoiding the use of client funds. When this is done, a record (i.e., ledger card) should be maintained concerning the deposit and disbursement of these funds. Some lawyers direct their bank to bill the office operating account for service charges on the trust account if both accounts are maintained at the same bank. On occasion, the bank will incorrectly debit the trust account. If the trust account is incorrectly charged, the error may result in client funds being used to pay the charge and the trust account must be reimbursed promptly.

3. Outstanding Checks

There are several ways to address the problem of trust account checks that are not cashed for a significant period of time. Some lawyers print "Void After 90 Days," on trust account checks to persuade payees not to hold the checks. The notation does not guarantee that the bank will not honor the check after 90 days. This issue should be addressed with the bank in advance. Other lawyers contact all recalcitrant payees who fail to negotiate a trust account check after a certain period of time (usually six to nine months). Certified mail should be used if warranted by the amount of the check. If the payee cannot be located or a reply is not received within a reasonable time, the check is voided or a stop payment is placed on the check. The stop payment charge has to be paid and a stop payment is usually good for only six months. If the check is voided, it may still be negotiable. Therefore, a stop payment order may be more appropriate depending on the amount of the check. If a stop payment order is placed on a check, the check may still be cashed. The bank's procedures for stop payment orders should be understood in advance. After payment is stopped on a check, the funds are noted as returned on the client's ledger card. There is not a restriction on issuing a second trust account check. If the lawyer believes that funds have been abandoned, the lawyer must follow the escheat requirements set forth in T.C.A. 66-29-101 to T.C.A. 66-29-204.

May a lawyer unilaterally decide to use funds held in trust to pay his or her legal fees or the claims of other creditors?

As the client's agent and fiduciary, the lawyer has an obligation to pay or deliver the funds in accordance with the client's most recent instructions. Unless the lawyer is authorized by the client to pay a particular charge or claim, the lawyer may not disburse trust funds for those purposes. See RPC 1.15.

What if the lawyer has an interest in funds received in settlement of a claim or in satisfaction of a judgment?

All receipts of trust funds must be deposited into the trust account intact. If an item represents funds belonging in part to the client and in part to the lawyer, the portion belonging to the lawyer must be withdrawn when the lawyer becomes entitled to the funds unless the right of the lawyer to receive the portion of the funds is disputed by the client. In that case the disputed portion must remain in the trust account until the dispute is resolved. See RPCs 1.15(e).

Is it proper for a lawyer to disburse settlement funds conditionally delivered by opposing counsel before satisfying the settlement conditions under which the lawyer received the settlement check?

No. When a lawyer accepts conditional delivery of settlement proceeds from opposing counsel, the lawyer implicitly agrees to abide by the prescribed conditions. While it may not be a violation of RPC 1.15, any deliberate failure to abide by those conditions, such as by disbursing the proceeds without first having obtained a signed release, would be dishonest and violative of RPC 8.4(c), which prohibits “conduct involving dishonesty, fraud, deceit or misrepresentation.”

B. Overdrafts and Checks Presented Against Insufficient Funds

What should a lawyer do if his or her trust account check bounces?

Theoretically, of course, this should never happen. As a practical matter, however, mistakes do happen and bank errors or administrative snafus within the lawyer's own office can result in an item's being returned for insufficient funds. If a trust account check is dishonored, the lawyer should immediately ascertain the nature of the problem and promptly correct it, even if this requires a deposit of the lawyer's own funds into the trust account. Under no circumstances should the lawyer allow the trust funds of another client to be used impermissibly. Reimbursement of the trust account should NOT be held in abeyance pending resolution of the error (e.g., by locating the party responsible for a bad check). Any delay in reimbursing the account may result in the use of other client funds to cover the shortage which is not permitted.

Finally, the lawyer should immediately document the problem and any corrective action taken in a memorandum for his or her own files.

Must a report be made to the Board of Professional Responsibility?

Every lawyer must open a trust or escrow account at an approved financial institution which agrees to notify the Board of Professional Responsibility when any check drawn on a trust account or a fiduciary account is presented for payment against insufficient funds. Rule 9 § 35. Note that the reporting requirement applies to the presentation of an instrument against insufficient funds, not just to the return of an instrument for insufficient funds.

The rule requires a lawyer to maintain trust accounts and fiduciary accounts only at a bank that agrees to notify the Board of Professional Responsibility pursuant to the agreement. The lawyer must ensure that the bank understands that the directive applies to all trust and fiduciary accounts of the lawyer, not just to general trust accounts (sometimes called "IOLTA accounts" by banks). Lawyers with signatory authority on fiduciary accounts, such as estate accounts, should also comply with this requirement.

The purpose of the directive is to prevent defalcations by giving the Board notice when a trust account may be overdrawn. The requirement greatly diminishes the possibility that a lawyer engaged in misappropriation of trust funds can hide such activity by directing the depository bank to notify him or her prior to the return of a check for insufficient funds in order that the lawyer might deposit funds into the account before the item is returned and thereby avoid the reporting requirement.

A lawyer who overdraws a trust account or a fiduciary account may soon expect to be contacted by a representative of the Board who will informally request an explanation of the problem. Once it is verified that an innocent mistake caused the shortage or apparent shortage in the account, the inquiry will be concluded and no further action will be taken. If, however, no adequate explanation is immediately forthcoming, a complaint will be opened and an investigation conducted.

Section 8: Recordkeeping

Some lawyers have the misconception that they cannot fulfill their ethical responsibility to keep track of their clients' money without spending a great deal of money on computer hardware and software that they will then have to spend a great deal of time learning how to use. While this is not true, technology can certainly make the process easier, particularly for lawyers and firms that have a high volume of trust account transactions.

Rule 8, RPC 1.15, and Rule 43 do not mandate any particular client trust-accounting system. (However, keep in mind that Formal Ethics Opinion 89-F-121 does spell out the particular records you must maintain.) You can hire consultants to set up a system, buy computer accounting software—whatever works for you—as long as you get the results and keep the records that the Rules require. The system described below will give you everything you need to do in order to account for your clients' funds.

The following client trust accounting system is designed for sole practitioners and lawyers in small law firms. It assumes that you will be directly involved in every aspect of handling your clients' money. However, whatever size firm you work in and whatever client trust-accounting system you use, you still have full personal fiduciary responsibility for accounting for your clients' money. Keeping records is the way you do the “accounting” part of client trust-accounting. Record-keeping must be done consistently and keeping incomplete records is just as great a breach of your ethical responsibility as keeping no records at all.

There are a few things that must be kept in mind in formulating procedures for handling the trust account, whether the lawyer uses a manual or a computerized system. These are:

- The lawyer may delegate duties, but cannot delegate responsibility or accountability for the trust account. Therefore, the lawyer must:
 - understand the types of records that must be maintained and how a trust account operates to properly train and supervise employees who maintain the account;
 - train all employees who will handle trust account functions;
 - supervise all employees who will handle trust account functions on an ongoing basis, not just when they are new; and
 - review trust account records regularly, including bank statements, the general ledger/checkbook register, deposit slips, individual client ledgers, etc.
- The lawyer or firm must establish and rigorously follow good internal control procedures. This includes:
 - don't make the same person responsible for receiving funds, recording funds and disbursing funds;
 - special precautions for handling cash;
 - the lawyer must be part of the internal controls system;
 - taking specific steps to reduce the risk of misappropriation;
 - not assuming that any individual will be impervious to temptation;
 - monitoring and enforcing use of the established internal control procedures; and

- analyzing the potential effect on internal control procedures of downsizing, redistribution of duties or replacement of staff members and modifying procedures as necessary to compensate.

In establishing the system for maintaining the trust account, there are also some procedures that must be included, whether the system is manual or automated.

- Every transaction must be recorded in full detail, including date, payee of funds disbursed/payor of funds deposited, applicable client, check number, amount, reason for disbursement or deposit, etc.
- A current balance must be available at all times, both for the trust account as a whole and for each individual client on whose behalf money is being held.
- A ledger (or its equivalent) must be kept for each individual client whose money is being held that indicates the full history of that client's funds, including receipts and disbursements until the last penny has been paid from the account.
- A reconciliation of the account must be performed no less frequently than quarterly. Formal Ethics Opinion 89-F-121.
- Compare client ledgers to the general ledger/checkbook register. The total balance of all client ledgers should match the total on the general ledger/checkbook register.
- Reconcile to the bank statement, adjusting for outstanding checks, deposits in transit, bank charges, etc.
- Resolve any discrepancies immediately – they are usually easy to find if they are isolated to the period since the last bank statement and much more difficult to find as time passes.

As we've discussed, Rule 9 § 35.1(a)(2) requires you to keep two kinds of records: records created by the bank that show what went into and out of your client trust accounts; and records created by you to explain the transactions reflected in the bank documents.

A. How long must you keep records?

Rule 9 § 35.1(a)(2) requires you to keep trust account records for a period of at least five years after disposition of the underlying matter.

B. What if you have a computerized system?

Even if you have a computerized accounting system, you may want to keep hard copies of all the records required by the Rule (including bank-created records). You can use computer printouts instead of hand-written ledgers for the records you are responsible for creating, but just having the data stored electronically in the cloud, on a drive (local or external), or saved to storage media is risky. (It's a good idea to have these printouts dated and signed by the preparer to show when and by whom they were generated.) Remember that there are numerous computerized systems and no one knows how everyone works. Your records must be accessible and understandable to the Board.

If you're using a computerized accounting system, applications or other technology tools, you should remember that computer data can be lost through natural disaster (like earthquake or fire), power or equipment failure, cyberattack, and human error. For your own protection, make hard

copies regularly and have all of your computer records regularly backed up to the cloud, on a drive (local or external), or on storage media.

Beyond preservation of the computer data, you also should be very careful when changing or upgrading your specific accounting software application, your overall computer operating system, and the computer hardware itself. Different software applications and newer versions of the same software application may not be fully compatible with the data generated by your current software application. Similarly, changing computers or operating systems can cause difficult compatibility problems. These days, it is not unusual for computer technology to advance dramatically in a five-year time period, rendering some application data obsolete and problematic to use. In addition, a special note for web-based applications is that browsers change over time, and it is not unusual for a common component or functionality of a browser to be discontinued or no longer be supported at some point in the future. An example is the 2020 end of life for Adobe Flash support that impacted many browser-based applications in 2021.

To avoid problems, a person's ordinary use of a smartphone requires responsible steps, such as regularly backing up data, and this is true of accounting technology. Accounting technology should not be avoided simply because there are potential problems as it offers the advantages of efficiency and reliability and can avoid the errors that arise from manual entries on hard copy accounting forms.

C. Which bank-created records do you have to keep?

You are required to keep these bank-created records: client trust account statements, canceled checks and check stubs. Some lawyers don't take their duty to keep bank-created records seriously because they can always get copies from their bank. If your bank fails, merges with or is taken over by another bank, you may find that copies of your four-year-old canceled client trust account checks just aren't available. As previously noted, finding a bank that still offers "canceled checks" may take some searching and if you're unable to find such a bank, be sure to access and maintain "canceled check" information by requesting check imaging or other documentation from your bank.

D. How should you file bank-created records?

To ensure that you have a complete set of bank-created records, and to save you time when you need to find a particular record, you should have a simple, consistent filing system. One good system is to keep separate binders for each of your client trust accounts. Each binder should have one section for bank statements, one section for canceled checks, one section for deposit slips and one section for checkbook stubs. File each record in date order in the appropriate section of the binder for the account they refer to. Just label each binder with the name of the client trust account and the period it covers, and you should be able to find any record in one or two minutes.

An even simpler recommendation is to keep deposit slips and canceled checks in the same envelope as the bank statement to which they are associated, or print these documents using online account access and attach them to a copy of the bank account statement.

E. What records do you have to create?

You need to create three kinds of records to show that you know at all times what you're doing with your clients' money. We'll discuss each of these records in detail below, but a few general points apply to all of them:

Tenn. Sup. Ct. R. 9 § 35 requires you to retain these records for a minimum of five years after the representation ends.

NEVER round off figures in these records. You must keep "complete records of such account funds." That means all receipts and payments must be recorded to the penny.

These records can be handwritten, typed or printed out from a computer file. However, they should be complete, neat and legible, and stored in such a way that you can find them—and read them—as many as five years later. Handwritten records should be kept in ink—not pencil or magic marker—in bound accounting books, and typed records or computer printouts should be filed in binders. As with bank-created records, you can save yourself time and trouble by labeling the covers of the books and binders with complete account or client names and the dates the records cover.

All deposits and payments should be recorded in the general ledger/checkbook register and client ledger as soon as possible. Waiting longer increases the chance that you will forget to record a transaction or will record it incorrectly. It also means that your records aren't up-to-date and that you might be spending money your clients don't have.

You must also keep your client trust account deposit slips, checkbook stubs and/or records so you will have a complete audit trail. These records will make it much easier to balance your books and to show what you did with your clients' money.

The Client Ledger. You must keep, create and maintain a client ledger or its equivalent for each client (for example, a break-out by client created by your computerized program) whose money you hold. This client ledger must give the name of the client, detail all money you receive and pay out on behalf of the client, the name of the payor of funds deposited or payee of funds disbursed, and show the client's balance following every receipt or payment.

Maintaining a client ledger is like keeping a separate checkbook for each client, regardless of whether or not the client's money is being held in your common client trust account. The only difference between properly maintaining a client ledger and properly maintaining your personal checkbook is that you can be disciplined if you fail to properly maintain your client ledger.

Every receipt and payment of money for a client must be recorded in that client's client ledger. For every receipt, you must list the date, the amount, purpose and payor (the source) of the money. For every payment, you must list the date, the amount, the payee (to whom the payment went) and purpose of the payment. After you record each receipt, you must add the amount to the client's old balance and write in the new total. After you record each payment, you must subtract the amount from the client's old balance and write in the new total.

Client: Alpha, A				Matter: 111111		
R	Number	Date	Description of Transaction (Payor/Payee)	Payment	Deposit	Balance
	Deposit	12/14/2012	Deposit Alpha - fees		\$250.00	\$250.00
	1001	01/17/2013	Dee Fender, Esq. – earned fees	\$250.00		\$0.00

When you deposit more than one check at a time for a client (i.e., using one deposit slip for all the checks), you should record the name of each client in your general ledger/checkbook register, as well as on the deposit slip. If you don't, it will be harder to reconcile your books and to answer any questions that may come up later.

You will find it much easier to keep your records straight if you don't put more than one client's records on a given page. You also shouldn't use the front of a page for one client and the back of the page for another. This means wasting some paper, but it will enable you to file all the client ledger pages that refer to a given client in chronological order and find those pages faster if you need them. If you're handling more than one case for the same client, you should maintain a separate client ledger for each matter. NOTE: Use special caution when dealing with multiple matters for the same client. Each matter should be uniquely identified and always use the same identification for the particular matter on all documents referencing it so there will be no confusion.

Trust Receipts and Disbursement: RPC 1.15 says that you are allowed to deposit your own money to pay bank service charges or fees on that account, but only in an amount necessary for that purpose. The rule allows you to keep your own money in the account to cover bank charges; it doesn't require you to. Some lawyers arrange with the bank to have those charges assessed against their operating or personal accounts.

If you deposit your own money into your client trust account to cover the charges, you may be concerned about how much is reasonably sufficient. That depends on the kind of bank charges you expect and how often you expect to incur them. For IOLTA accounts, there are other kinds of bank charges you may incur, including charges for printing checks, for checks that are deposited in the account and returned for insufficient funds, and for transferring money by wire, etc. You need to know what these charges are so you can make sure that you always have enough money in the account to cover them.

When the bank charges for a service (e.g. for wiring money) for a specific client, you can treat the charge as you would any other cost and pay for it out of money you are holding for that client in the account. But some charges, like printing checks, aren't specific to a certain client. Like your other general operating expenses, you — not your clients — have to pay these charges. That's why the rules allow you to keep a little of your own money — an amount "for the sole purpose of paying bank service charges on that account, but only in an amount necessary for that purpose" — in your client trust account.

Remember that a deposit of your own money to cover bank charges, like every deposit you make to your client trust account, must be properly recorded in the general ledger/checkbook register for your client trust account, and an Administrative Funds ledger. You should keep the “Administrative Funds” ledger the same way you keep your individual client ledgers, recording every deposit, every charge the bank makes against the account, and the running balance of money you have left to cover the charges.

Client: Administrative Funds, Dee Fender, Esq.				Matter: 999999		
R	Number	Date	Description of Transaction (Payor/Payee)	Payment	Deposit	Balance
	Deposit	12/01/2012	Deposit to open account - Fender		\$50.00	\$50.00
	Bank Fee	07/18/2013	Client Epsilon Returned Deposit Fee	\$5.00		\$45.00
	Deposit	07/31/2013	Client Epsilon Returned Deposit Fee		\$5.00	\$50.00

The general ledger/checkbook register: This is a written journal for each client trust account. You must keep track of the money going in and out of a client trust account on a general ledger/checkbook register, and give the account balance after each receipt or payment. When you have a trust account that’s designated solely for one client’s money, the general ledger/checkbook register will be identical to the client ledger.

Maintaining a general ledger/checkbook register is the only way you can know how much you have in the account at any given time. If you maintain the general ledger/checkbook register properly, you will not overdraft the client trust account unless there is a bank error.

In the general ledger/checkbook register, you must record every deposit into and payment out of the client trust account. For every deposit, you must record the date you deposited the money, the payor (source) of the funds deposited, and the amount of money you deposited. After you record each deposit, you have to add the amount to the account’s old balance and write in the new total. For every payment, you must list the date, the payee of the funds disbursed, and the amount of the payment. After you record each payment, you have to subtract the amount from the account’s old balance and write in the new total. Although it’s not required by the rule, you will find it a lot easier to balance your books if you also record the client name and number of the check.

General Ledger/Checkbook Register						
R	Number	Date	Description of Transaction (Payor/Payee)	Payment	Deposit	Balance
	Deposit	12/01/2012	Deposit to open account - Fender		\$50.00	\$50.00
	Deposit	12/15/2012	Deposit – advanced fees – client Alpha		\$250.00	\$300.00
	1001	07/17/2013	Dee Fender, Esq. – earned fees	\$250.00		\$50.00
	Bank Fee	07/18/2013	Client Epsilon Returned Deposit Fee	\$5.00		\$45.00
	Deposit	07/31/2013	Client Epsilon reimbursement for \$5 returned deposit bank charge		\$5.00	\$50.00

After taking into consideration the above requirements, a lawyer has numerous choices for software programs to computerize trust account procedures. The lawyer should consider the volume of transactions, the amount of money he or she can or is willing to spend on software and the hardware that will run it, the computer skills of the lawyer and of all staff members who will be assisting, and the availability and cost of training in his or her community.

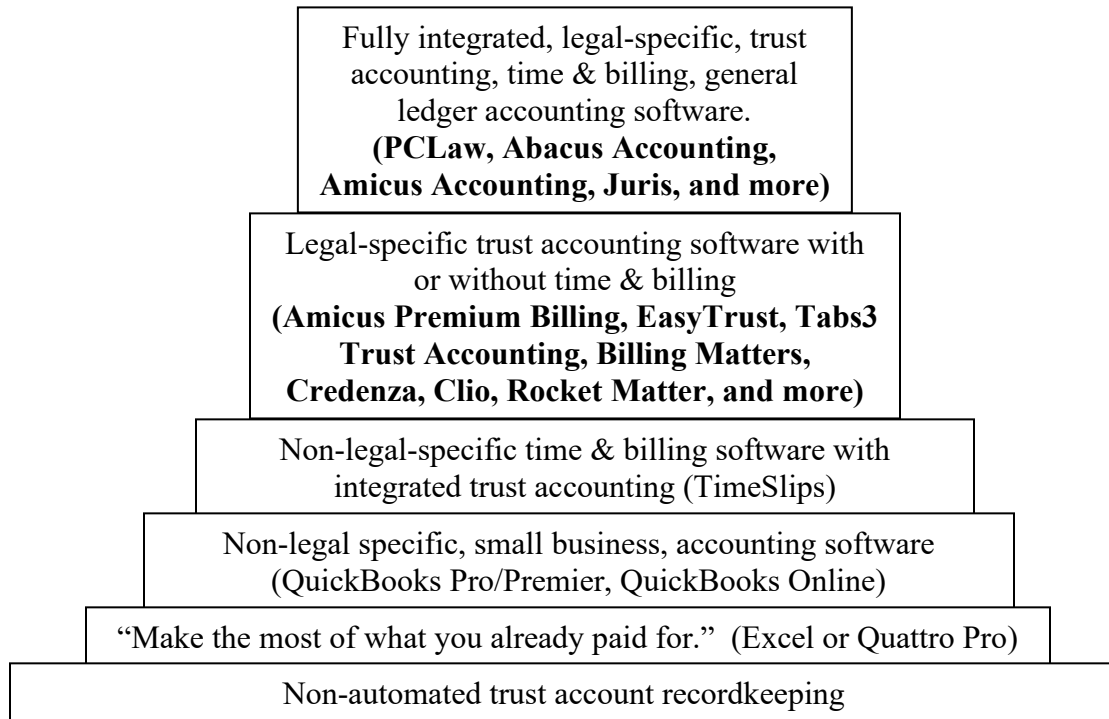
Most of the complicated timekeeping/billing software being used by medium and large firms includes modules for handling the trust account. Because staff members are already trained on the basics of the timekeeping/billing product and the module is designed to work in an integrated fashion with the main program, firms will typically utilize a module for trust accounting.

F. Automated Alternatives to Managing Your Trust Account

Automating your trust account recordkeeping process can reduce the amount of data entry and calculation errors. You can search and find trust account information quickly, and perhaps from remote locations. Automating can organize the routine process of maintaining your trust account. It can save you space, but ALWAYS print copies of your client ledgers, general ledger, and reconciliation.

Choices for software packages range from the basic to the sophisticated:¹

¹ This is not an exhaustive list. The Board of Professional Responsibility does not guarantee or endorse any particular software package.



Excel and Quattro-Pro are not legal-specific. These programs are free if you own the Microsoft Office Suite or Corel Suite. These are relatively easy to learn for basic trust account management purposes. They are good for lawyers not needing to integrate the trust accounting function with time and billing or other practice management software. These are good for firms with 10 clients or fewer with limited activity.

A sole practitioner or small firm with few transactions may find a simple, inexpensive program that functions basically, like a checkbook to be satisfactory for maintaining the trust account. Quicken, for example, will not only do the math to provide a running balance for the entire account, but can be set up to provide the equivalent of an individual client ledger by using the client name in the “category,” field. The lawyer can then sort by “category” and get a display on the screen or a print-out of all deposits and disbursements related to that client, including a running balance.

Quicken is one example of a single entry bookkeeping program. In a single entry system, only one entry is made for any given transaction. For example, when a check is written in Quicken, the lawyer simply enters the amount of the check and the computer deducts it from the balance. Although the lawyer must designate the client in “category” if he or she wants to use the computer to create client ledger equivalents, there is no need to enter both debits and credits.

Quicken is inexpensive. It is integrated with tax preparation software, such as TurboTax. It is user-friendly and easy to learn. Quicken has limited automated functions for the trust account, but can be customized to accommodate a law firm trust account. The system must be set up to show running balances on all ledger reports, which can be difficult to do. The program is networkable; however, the software company will not provide technical support if it is on a network. Quicken can print checks and the Home and Business version is capable of limited invoicing.

In a double-entry system, however, there must be at least one debit and at least one credit for each transaction, with the total dollar amount recorded as debits always equal to the total amount recorded as credits. Examples of double-entry bookkeeping systems are QuickBooks and Peachtree.

QuickBooks Pro/Premier have more features for law firms, yet it is not legal-specific. It now has Legal Wizard to guide you through the installation, and will set up reimbursable cost accounts, (i.e. copies, postage). The software links to Amicus Attorney, Time Matters, Practice Master, and more. With the Case Management program link, it provides a fully integrated accounting function.

QuickBooks Online is considered a software-as-a-service (SaaS) system. You pay a monthly subscription for its use, and it's accessible from anywhere you have an internet connection. It has features for law firms, but is not legal-specific.

TimeSlips (by Sage) has a trust account capability integrated with time and billing functions. It is not legal-specific, but many solo practitioners and small law firms use it. TimeSlips links with Amicus Attorney, Time Matters, Abacus Law, and other case management programs. You can purchase an extra module for handling a general account. Remember, however, that TimeSlips must be set up so that a running balance after each transaction is included on all ledgers.

Tabs3 is a specific program for managing a trust account. Tabs3 can track up to nine trust accounts. It can print IRS Form 1099 as well as checks. Tabs3 provides fully integrated time and billing functions, firm accounting and case management (Tabs3, General Ledger, and Practice Master). Easy-Trust is a legal-specific software program used for managing a trust account only. It is user-friendly and easy to learn. Easy-Trust can even print checks. It prepares three-way reconciliations reports. Easy-Trust is a stand-alone program or it can be networked, and may be combined with Easy-TimeBill for billing; however, it does not link with any case management software.

PCLaw is a legal-specific program that provides fully integrated trust accounting, time and billing features, and general ledger accounting. The Pro Version includes calendaring, document management, and case management functions. Modules are also available for remote computing. The program can also print checks and e-mail invoices.

Billing Matters has a legal-specific version available. The program has fully integrated trust accounting, time, and billing features. It offers a seamless integration with front office and case management functions (Time Matters.) It can also be purchased as an optional "add-on" to TimeMatters.

Abacus Accounting is legal-specific. The program has fully integrated trust accounting, time and billing features, general ledger accounting and payroll functionality. It offers a seamless integration with front office and case management functions (Abacus Law). The program is not available as a stand-alone. It can print checks and e-mail invoices.

Amicus Accounting is legal-specific. The program has fully integrated trust accounting, time and billing features and general ledger accounting functionality. It offers a seamless integration with

front office and case management functions (Amicus Attorney Small Firm). It can be purchased as a stand-alone program, and it prints checks as well.

Amicus Premium Billing is legal-specific. The program has fully integrated trust accounting, time and billing features, but not general ledger. An optional module with full front office and case management functions (Amicus Premium) is available. The program is not available as a stand-alone. It can also print checks.

Credenza Pro is legal-specific. The program has fully integrated trust accounting, time and billing features, but not general ledger capabilities. It can integrate with QuickBooks. Credenza Pro includes front office and case management functions. It is an Outlook “add-in,” but cannot print checks.

In addition to the single and double entry software programs designed for general business use, there are also a number of programs specifically designed for law offices. Several, including PC Law Jr. and TABS III, are available at prices affordable for solo or small firms practitioners. Other choices include more sophisticated and therefore more costly programs, and add-on modules to programs that perform a wide range of timekeeping, billing and accounting functions.

One of the practical differences between general business and law-specific accounting software is that law-specific programs are built around the concept that each client’s money in a trust account has to be accounted for separately from every other client’s money. Therefore, when an entry is made in the trust account for a disbursement, the software prompts the user to enter the name of the clients and automatically performs a check to assure that that particular client has adequate funds to cover the disbursement.

Once the transaction is made, the software automatically updates that client’s ledger as well as the overall account records. By contrast, in a program not designed specifically for legal use, there is no automatic check of the total for the individual client, and the computer user must take steps (such as sorting the general ledger/checkbook register by category) to determine whether the particular client has sufficient funds.

Some lawyers don’t want to change the product they currently use for timekeeping and billing, but want to link to a program that supplements their system with the ability to maintain records on both the trust and operating accounts. An example of this combination is TimeSlips, which, although it was not specifically designed for lawyers, is widely used in the legal environment for timekeeping and billing. Another example is Quicken.

Using a computerized program for maintaining the trust account reduces the risk of mathematical error and provides the capability to sort data to instantaneously acquire information about a client’s funds on the screen. However, all computer programs still require human input of data, and, while the risk of human error can be reduced by decreasing the need for multiple entries of the same data, the risk of human error cannot be totally eliminated through technology. Therefore, the lawyer, who is the person most familiar with the client’s matter and the one most likely to recognize if an error has occurred, must still be vigilant in assuring that the client’s money is properly protected and accounted for until its final disbursement.

G. What records do you have to keep of other properties?

You have a responsibility to protect and keep track of any client property, even if it is not money. It is important that at any point in time you know what property you are holding, when it was received and where it is located. For example, if you are holding securities for a client they should be kept in a secured place such as a safe deposit box and you should have a log showing when you received the securities, which bank they are located at, and if returned to the client, the date you returned them.

H. Other Resources

- Go to the vendor website.
- Read features, versions, and hardware requirements.
- Read compatibility with other software (Palm software, time & billing, accounting)
- Training and/or manuals provided.

I. Reminders

- After each transaction, calculate and record a new running balance of the total in the account on the general ledger/checkbook register, as well as a running balance on the respective individual ledger for the client on whose behalf the transaction was made.
- Each month, perform a three-way reconciliation: Calculate the total for all individual client ledgers, compare that to the total in the general ledger/checkbook register (if it doesn't match, find the discrepancy before proceeding), then reconcile your general ledger/checkbook register to the bank statement, adjusting for outstanding checks, deposits in transit (made after your bank's cut-off for that month's bank statement), and any bank charges.
- Remember that trust account records, including bank statements, canceled checks, duplicate deposit slips, client ledgers and reports to clients accounting for their funds, must be maintained for a minimum of five years following termination of representation of that specific client.
- ALL transactions must be recorded to a ledger.
- Total of the ledgers should always match the balance in the general ledger/checkbook register.

Section 9: Reconciliation

“Reconciliation” means checking the three basic records you are required to keep - the bank statements, the client ledgers, and the general ledger/checkbook register - against each other so you can find and correct any mistakes.

Formal Ethics Opinion 89-F-121 requires you to reconcile your client trust account records. Even banks make mistakes when it comes to recording money transactions. That is because when you are working with numbers, mistakes are easy to make and difficult to notice. No amount of training can completely eliminate these mistakes.

To make sure that you find and correct these mistakes, you must record every client trust account transaction twice (in your client ledger and your general ledger/checkbook register), and check these records against each other and against the bank’s records. For example, let’s say you deposit a check for \$1,000 into your client trust account but mistakenly record it as “\$10,000” in your client ledger and add \$10,000 to your client’s running balance. In your general ledger/checkbook register, you recorded the check correctly and added \$1,000 to your client trust account’s running balance. How will you find the mistake? The general ledger/checkbook register balance is right, so you won’t find the mistake by bouncing a check. The numbers in the client ledger all add up so there is no way to tell you made a mistake. Unless you compare your client ledger balance to your general ledger/checkbook register balance, you won’t be able to find the recording error. And unless you compare your client ledger and general ledger/checkbook register against the bank statement, you won’t know which entry was right - \$10,000 or \$1,000.

We have just described the quarterly reconciliation process. The theory is that it is unlikely that the same mistakes will be made in three different records - the client ledgers, the general ledger/checkbook register, and the bank statement - so if those records are all checked against each other, any mistakes will show up.

Formal Ethics Opinion 89-F-121 requires quarterly reconciliations of the trust account balance to the current bank statement for a trust account, while noting that monthly reconciliations is a better practice. However, there is an important distinction between the basic reconciliation that must be done monthly and the more thorough reconciliations that must be done each quarter.

A. Monthly Reconciliation

You cannot do a reconciliation for a month until you are sure you have correct balances in all your client ledgers and general ledger/checkbook register for the previous month. If you have not recently reconciled your books, or if you are worried that they are wrong, you may want to bring in a bookkeeper to straighten them out before you take on the monthly and quarterly reconciliations yourself.

Once you have correct balances for the previous month, you are ready to reconcile. The steps required for this type of reconciliation are not unlike those necessary to balance a personal checking account.

There are two main steps in reconciling monthly:

1. From the balance shown on the bank statement for the monthly reporting period, subtract all outstanding checks. To this amount, add all deposits that have not cleared the bank. This is the current bank balance.
2. Confirm that the current bank balance equals the total balance for the trust account as shown on the lawyer's records (if using manual accounting, this would include check stubs or the account register).

The cut-off date for the bank statement and the trust account balance must be the same or the two balances may not reconcile. Note that the "Reconciliation Summary" produced by accounting software will typically satisfy the monthly requirement to reconcile the current bank balance to the total trust account balance (a different software report may be necessary for the quarterly reconciliation).

B. Quarterly Reconciliation

Formal Ethics Opinion 89-F-121 requires a quarterly reconciliation of the trust account. The quarterly reconciliations require the extra step of adding up individual balances for each client as shown on the trust account ledger and making sure that this total reconciles to the bank current balance for the month at the end of the quarter. Quarterly reconciliations promote accurate accounting for client funds by ensuring that the running balances for each client, when totaled, equal the total funds on deposit in the trust account.

Remember that a three-way reconciliation should be conducted **every quarter** for **every** client trust account.

When completing the three-way reconciliation, it is a good idea to use a calculator that will produce a printed record of the calculation you performed. That way, if your records do not match, you can easily check to see if the reason is a mathematical mistake made while performing the reconciliation.

You are required to retain these three different records and the reconciliation reports for five years to satisfy the recordkeeping requirement in Tenn. Sup. Ct. R. 9 § 35. If your software does not allow you to retrieve a hard copy of the reconciliation report at a later date, a hard copy should be printed at the time of reconciliation.

It is fine to hire a bookkeeper or the equivalent, but you are still personally responsible for accounting to your clients and to the Board of Professional Responsibility for the money in your client trust accounts. Therefore, even if you never intend to do the reconciling, you should understand the process. Even if it is your bookkeeper's mistake, if you bounce a client trust account check, you are the one your client or the Board is going to come to for an explanation.

C. Example of Three-way Reconciliation

The detailed example below illustrates a manual method that can be used to perform the three-way reconciliation on a general trust account required each quarter. This is not the only method that can be used, as any method that satisfies the rules will be sufficient.

These are the client ledgers that will be used for the three-way reconciliation example (Note: the “R” box is a check-box for use during the reconciliation):

Client: Alpha, A.		Matter: 111111				
R	Number	Date	Description of Transaction (Payor/Payee)	Payment	Deposit	Balance
	Deposit	01/15/2011	Deposit - fees		250	250
	1001	01/17/2011	Dee Fender, Esq. – earned fees	250		0

Client: Beta, B.		-FEES Matter: 222222				
R	Number	Date	Description of Transaction (Payor/Payee)	Payment	Deposit	Balance
	Deposit	01/20/2011	Deposit - \$1,000 fees		\$1,000	\$1,000
	1004	02/01/2011	Dee Fender, Esq. – earned fees	\$600		\$400
	1005	02/05/2011	Dee Fender, Esq. – earned fees	\$400		\$0

Client: Beta, B.		-COSTS Matter: 222222				
R	Number	Date	Description of Transaction (Payor/Payee)	Payment	Deposit	Balance
	Deposit	01/20/2011	Deposit - \$500 costs		\$500	\$500
	1002	02/01/2011	Superior Court – Nowhere County Filing Fee – Cost	\$125		\$375
	1003	02/05/2011	Nowhere Vital Records – Birth Cert. - cost	\$75		\$300

Client: Gamma, G.		-FEES Matter: 333333				
R	Number	Date	Description of Transaction (Payor/Payee)	Payment	Deposit	Balance
	Deposit	02/08/2011	Deposit - \$1,200 fees		\$1,200	\$1,200
	1007	02/11/2011	Dee Fender, Esq. – earned fees	\$1,200		\$0

Client: Gamma, G.		-COSTS Matter: 333333				
R	Number	Date	Description of Transaction (Payor/Payee)	Payment	Deposit	Balance
	Deposit	02/08/2011	Deposit - \$250 costs		\$250	\$250
	1006	02/11/2011	Record Round Up - costs	\$150		\$100

Client: Delta, D.		-FEES Matter: 444444				
R	Number	Date	Description of Transaction (Payor/Payee)	Payment	Deposit	Balance
	Deposit	02/15/2011	Deposit - \$15,000 fees (unearned)		\$15,000	\$15,000
	1008	02/17/2011	Dee Fender, Esq. – earned fees 8 hours @ \$250/hr	\$2,000		\$13,000
	1009	02/17/2011	D. Delta - refund	\$13,000		\$0

Client: Epsilon, E.		Matter: 555555				
R	Number	Date	Description of Transaction (Payor/Payee)	Payment	Deposit	Balance
	Deposit	03/15/2011	Deposit - \$2,000 fees (unearned)		\$2,000	\$2,000
	Returned Deposit	03/20/2011	Returned deposited check for insufficient funds	\$2,000		\$0
	Deposit	03/31/2011	Deposit - \$2,000 fees (unearned)		\$2,000	\$0

Client: Administrative Funds, Dee Fender, Esq.				Matter:	999999	
R	Number	Date	Description of Transaction (Payor/Payee)	Payment	Deposit	Balance
	Deposit	01/01/2011	Deposit to open account		\$50	\$50
	Bank Fee	03/20/2011	Client Epsilon Returned Deposit Fee	\$5		\$45
	Deposit	03/31/2011	Client Epsilon reimbursement for \$5 returned deposit bank charge		\$5	\$50

This is the general ledger/checkbook register that will be used for the three-way reconciliation example:

General Ledger/Checkbook Register						
R	Number	Date	Description of Transaction (Payor/Payee)	Payment	Deposit	Balance
	Deposit	01/01/2011	Deposit to open account		\$50	\$50
	Deposit	01/15/2011	Deposit – Alpha fees		\$250	\$300
	1001	01/17/2011	Dee Fender, Esq. – Alpha earned fees	\$250		\$50
	Deposit	01/20/2011	Deposit – Beta \$1,000 fees/\$500 costs		\$1,500	\$1,550
	1002	01/25/2011	Superior Court – Nowhere County Filing Fee – Beta cost	\$125		\$1,425
	1003	01/25/2011	Nowhere Vital Records – Birth Cert. – Beta cost	\$75		\$1,350
	1004	02/01/2011	Dee Fender, Esq. – Beta earned fees	\$600		\$750
	1005	02/05/2011	Dee Fender, Esq. – Beta earned fees	\$400		\$350
	Deposit	02/08/2011	Deposit – Gamma \$1,200 fees, \$250 costs		\$1,450	\$1,800
	1006	02/11/2011	Record Round Up – Gamma costs	\$150		\$1,650
	1007	02/11/2011	Dee Fender, Esq. – Gamma earned fees	\$1,200		\$450
	Deposit	02/15/2011	Deposit – Delta \$15,000 fees (unearned)		\$15,000	\$15,450
	1008	02/17/2011	Dee Fender, Esq. – Delta earned fees 8 hrs @ \$250/hr	\$2,000		\$13,450
	1009	02/17/2011	D.Delta – refund of unused advanced fee	\$13,000		\$450
	Deposit	03/1/2011	Deposit – Epsilon \$2,000 fees (unearned)		\$2,000	\$2,450
	Returned Deposit	03/20/2011	Epsilon – returned deposited check for insufficient funds	\$2,000		\$450
	Bank Fee	03/20/2011	Epsilon returned Deposit Fee	\$5		\$445
	Deposit	03/31/2011	Deposit – Epsilon \$2,000 fees (unearned with reimbursement for \$5 returned deposit bank charge		\$2,005	\$2,450

This is the trust account bank statement that will be used for the three-way reconciliation example:

Bank of Wegottayourmoney

Dee Fender, Esq.
 Dee Fender's IOLTA Trust Account
 1201 E. Easy Street, Suite #100
 Sunnyvale, NC 20010

Account Number: 000200800888
 Activity Through: 1/01/2011 – 03/31/2011

Beginning Balance 1/01/2011 \$50.00
Ending Balance 03/31/2011 \$520.00

Deposits/Credits

<u>Date</u>	<u>Dollar Amount</u>	<u>Type</u>
1/01/11	\$50.00	Deposit
1/15/11	\$250.00	Deposit
1/20/11	\$1,500.00	Deposit
2/08/11	\$1,450.00	Deposit
2/15/11	\$15,000.00	Deposit
3/15/11	\$2,000.00	Deposit

Total Deposits/Credits: \$20,250.00

Withdrawals/Debits

<u>Check #</u>	<u>Dollar Amount</u>	<u>Date</u>
1001	\$250.00	1/17/11
1002	\$125.00	1/25/11
1004*	\$600.00	2/1/11
1005	\$400.00	2/5/11
1006	\$150.00	2/11/11
1007	\$1,200.00	2/11/11
1008	\$2,000.00	2/17/11
1009	\$13,000.00	2/17/11

*Indicates preceding check (or checks) is outstanding

Other Withdrawals/Debits

<u>Type</u>	<u>Dollar Amount</u>	<u>Date</u>
Returned Deposit 3/15/11	\$2,000.00	3/20/11
Returned Deposit Fee	\$5.00	3/20/11

Total Withdrawals/Debits: \$19,730.00

Daily Balance

1.1.11	\$50.00	2/1/11	\$825.00	2/17/11	\$525.00
1/15/11	\$300.00	2/5/11	\$425.00	3/15/11	\$2,525.00
1/17/11	\$50.00	2/8/11	\$1,875.00	3/20/11	\$520.00
1/20/11	\$1,550.00	2/11/11	\$525.00	3/31/11	\$520.00
1/25/11	\$1,425.00	2/15/11	\$15,525.00		

THREE-WAY RECONCILIATION SHEET

Client Ledger Balances:

1)	<u>Administrative Funds</u> Client Name		<u>\$50</u>	Ledger Balance
2)	<u>Alpha</u> Client Name		<u>\$0</u>	Ledger Balance
3)	<u>Beta</u> Client Name		<u>\$300</u>	Ledger Balance
4)	<u>Gamma</u> Client Name		<u>\$100</u>	Ledger Balance
5)	<u>Delta</u> Client Name		<u>\$0</u>	Ledger Balance
6)	<u>Epsilon</u> Client Name		<u>\$2,000</u>	Ledger Balance
7)				
8)				
9)				
10)				

Step 1: Enter total client ledger balances as of 03/31/2011.....	\$2,450
Step 2: Enter general ledger/checkbook register balance.....	\$2,450
Step 3: Enter ending balance per bank statement, 03/31/2011.....	\$520
Step 4: Enter total outstanding deposits.....	\$2,005
(Deposits made to the account yet not captured on bank statement. These will be ADDED to the bank statement amount.)	
Step 5: Enter total outstanding checks.....	\$75
(Checks that have been drawn from the account yet not captured on bank statement. These will be SUBTRACTED from the bank statement amount.)	
Step 6: Subtract any bank service charges.....	\$0
Step 7: Calculate adjusted balance.....	\$2,450
(Ending bank statement balance plus outstanding deposits minus outstanding checks)	

Reconciliation: All three should match...

Total of all client ledgers.....	\$2,450
(Total from Step 1.)	
Adjusted Bank Balance.....	\$2,450
(Total from Step 7.)	
General ledger/checkbook register Balance.....	\$2,450
(Total from Step 2.)	

Reconcile the General Ledger/Checkbook Register with the Client Ledgers

For illustrative purposes only, the bank statement provided for this reconciliation covers the entire quarterly period of 1/01/2011 through 03/31/2011. In every day practice, your trust account bank statement would only cover one month, e.g., 01/01/2011 through 01/31/2011.

The first part of reconciliation is to reconcile the general ledger/checkbook register with the client ledgers. The purpose of this step is to make sure that the entries in your client ledgers agree with the entries in your general ledger/checkbook register.

Step 1: On the lines above “Client Name” write the name of each client whose money you are holding in the general trust account. On the lines above “Ledger Balance,” write the running balance as of the last day covered by the bank statement (in this case, March 31, 2011) from each client ledger next to the name of that client. Add up the client ledger balances in the “Ledger Balance” column and write in the total after “Total of Client Ledger Balances as of 03/31/2011.” Even if only one client’s money is in the general trust account, you have to write that client’s balance on this line.

Step 2: Notice that the “Total of Client Ledger Balances as of 03/31/2011” exactly matches the “General ledger/checkbook register Balance.” That means that your individual client ledger balance entries agrees with your general ledger/checkbook register entries, and you are ready to move on to the next step of the reconciliation process.

When the “Total of Client Ledger Balances” *does not* exactly match the “General Ledger/Checkbook Register Balance,” do not panic; you have found a mistake, and that is what **reconciliation** is for. You can call in a bookkeeper to help you, or make the correction yourself. Since you record every deposit and withdrawal twice, if you systematically compare each entry in the general ledger/checkbook register with the corresponding entry in the client ledger, and check the new balance you entered after each entry, you will always find the mistake. When you have found and corrected any mistakes, move on to Step 3.

Reconcile the General Ledger/Checkbook Register with the Bank Statement

Step 3: In the space after “Ending Balance per bank statement, 03/31/2011,” write in the running balance for the general trust account as of the last day covered by the bank statement.

Steps 4 and 5: The purpose of these steps is to make sure that the bank’s records of the deposits and withdrawals you’ve made to your general trust account during the past month match your records. Since you’ve already reconciled the client ledgers with the general ledger/checkbook register, you know that the entries in the client ledgers agree with the ones in the general ledger/checkbook register. Therefore, unless you find a mistake during this stage of the reconciliation process you only have to compare the bank statement with the general ledger/checkbook register.

Deposits and withdrawals not posted on bank statement. Generally, the bank sends out statements one to three weeks after the end of the month. As a result, by the time you reconcile the account, you will usually have made deposits or withdrawals that are not shown on the bank statement. In addition, checks you wrote or deposits you made may not have cleared by the time

the bank produced the statement, and therefore the amounts of those checks or deposits won't be reflected in the account balance shown on the bank statement. Thus, to compare the balance of the bank statement for the end of the month with the balance your general ledger/checkbook register shows for the end of the month, you have to adjust the general ledger/checkbook register balance by **adding** all un-credited deposits and **subtracting** all undebited withdrawals.

To find out which transactions have not been posted, you have to compare the entries on the bank statement with the entries in your general ledger/checkbook register.

Go through each entry on the bank statement and compare it to the corresponding entry in your general ledger/checkbook register. If the entry in the general ledger/checkbook register exactly matches the entry on the bank statement, mark off the entry in the general ledger/checkbook register to show that the money has cleared the banking process, and mark off the entry on the bank statement to show that you have verified it against the general ledger/checkbook register. The marks in the general ledger/checkbook register will help you keep track of items like checks that are never cashed, which otherwise can become those small, inactive balances that make your account harder to reconcile. The marks should be permanent (i.e. in ink) and clearly visible, but should not make it hard to read the entries. You should use the same mark consistently, to avoid confusion later.

When you are finished, all the entries on the bank statement should be checked off to show that you have verified them against the corresponding entries in the general ledger/checkbook register. Now go back through the general ledger/checkbook register to find any entries that are unmarked; these transactions haven't yet been debited or credited by the bank. As you go through the bank statement, there are two kinds of mistakes you may find:

1. A deposit or withdrawal listed on the bank statement that is not in your general ledger/checkbook register. To correct this mistake, go through your canceled checks (if it is a withdrawal) or deposit slips (if it is a deposit) until you find the one that reflects the transaction on the bank statement. If you cannot find a canceled check or deposit slip that matches the entry on the bank statement, contact your banker and ask him or her to help you track down the transaction. **DO NOT** record the bank statement entry in your records until you verify that the transaction occurred; banks make mistakes, too.

2. An entry in the bank statement is different from the corresponding entry in the general ledger/checkbook register. You correct this mistake the same way you correct a transaction you forgot to record. First, find the canceled check or deposit slip that shows the transaction to figure out which record is correct—the general ledger/checkbook register or the bank statement. If you cannot find a canceled check or deposit slip for this transaction, contact your banker and ask him or her to help you track it down before you make any changes in your records.

If the canceled check or deposit slip shows that the bank statement is wrong, write a note on the bank statement that clearly describes the mistake, then contact your banker and tell him or her to correct their records. If it shows that your general ledger/checkbook register is wrong, record the correction in the general ledger/checkbook register *and* the appropriate client ledgers. These must

be entered twice in both the general ledger/checkbook register and the client ledger for the client on whose behalf you deposited or paid out the money.

When you have found and corrected any mistakes, move on to Step 6.

Step 6: Make sure that bank charges reflected on the bank statement are also reflected in your records. Since you may not know what these bank charges are until you receive the bank statement, you need to enter them into your records after you receive the bank statement.

All bank charges must be recorded in the general ledger/checkbook register. If a bank charge was incurred on behalf of a specific client (as for example, a charge for wiring money to a client), the charge must also be entered in that client's ledger. (This ensures that the general ledger/checkbook register balance will continue to match the total of the individual client ledger balances.) If the charge was not for a specific client (for example, a charge for printing general trust account checks), the charge must also be entered in the Administrative Funds/Bank Charges ledger.

Calculate the Adjusted Balance

Step 7: In the space after "Calculate Adjusted Balance," write the balance **after** you calculate the following:

1. Ending Bank Statement Balance
2. Plus All Outstanding Deposit Amounts
3. Minus All Outstanding Check Amounts
4. Minus Bank Fees and Charges

Trust Reconciliation Sheet

The totals from Step 1 (all client ledgers), Step 2 (general ledger/checkbook register), and Step 7 (adjusted bank balance), should all match. If they do, you have successfully reconciled the account. If they do not, call in a bookkeeper or go back and recheck your ledgers and bank statement to find and correct the mistake(s). Now clip all the pages that relate to the reconciliation process together (and any calculator tapes) and file them.

Section 10: Internal Controls

A. The Need for Control

Having a good working set of accounting records is an essential step toward the sensible management of client trust funds. It is also the first essential step to avoiding theft. However, it is only a first step. Without required records, the lawyer has not met the obligation to clients or to the Court. Moreover, the lawyer without proper records can be responsible for knowingly, or negligently invading clients' trust funds. Equally important is the fact that the lawyer who has poor records is ripe for theft by partners, associates, bookkeepers, and secretarial employees.

Even when records are properly established, however, records alone do not satisfy the lawyer's ethical obligations and do not serve as a defense against theft by others. In order to meet these challenges, one must: (a) maintain records in proper working order; and (b) exercise control over these records by actively reviewing them in accordance with a regular oversight program. This chapter outlines some of the steps by which lawyers can control their client trust account and meet ethical obligations and minimize the possibilities of theft.

B. Diversification of Financial Functions

The cardinal rule in avoiding theft is to divide the monetary functions in a law office. This is particularly difficult for a small firm or sole practitioner. However, if one secretary, for example, is given authority and responsibility to handle the trust and business accounts, reconcile these accounts, handle bank statements and, occasionally, even sign checks, that one person can easily doctor the records to cover up a theft and avoid detection for a long period of time. The same is true where one lawyer in a firm has sole responsibility for accounts with no oversight. Either one could unilaterally steal from the law firm.

Ideally, functions can be divided this way:

- Only a lawyer may sign trust account checks.
- Only one secretary or bookkeeper should have access to trust and business accounts records. Access by many secretaries makes it more difficult to pinpoint responsibility and increases opportunities for theft.
- A separate staffer should open all mail and record all incoming checks, which should then be given to the secretary/bookkeeper responsible for maintaining the accounts.
- All accounting records should be reconciled by the lawyer or by an independent accountant or bookkeeper on a monthly basis.
- The lawyer responsible should receive directly all monthly bank statement unopened or directly by electronic transmission.

- An annual (or quarterly) audit should be done by an outside accountant.

This layered diversification of responsibility minimizes the opportunities for fraud, since successful theft in this system requires collusion between two or more persons.

C. Exercising Control of Records

Control is not a self-executing concept. It must be exercised. The following are positive steps that can be taken to exercise control over trust and business accounts funds:

- (a) When the lawyer signs trust account checks, a review of the client's ledger should be made to determine the validity of the checks drawn.
- (b) A periodic review should be made of the reconciliation book prepared by the secretary/bookkeeper to determine its correctness.
- (c) A perusal and inquiry of checks outstanding for an extended period of time should also be made periodically.
- (d) Randomly, a review of the current balance on the general ledger/checkbook register and the balance of funds reflected on the client's ledger should be undertaken when a disbursement is made to ensure that there are sufficient collected funds to accommodate the disbursement.
- (e) The bank statement (with canceled checks) should be delivered unopened to or directly by electronic transmission. The lawyer should then peruse the canceled checks for the following:
 - (1) Are the payees familiar?
 - (2) Are the clients who are named on the checks firm clients?
 - (3) Are endorsements made by the payee or by an employee in the law office?
 - (4) Are checks being cashed instead of being deposited? If so, communicate with one or two payees to make sure they received the money?
 - (5) Are duplicate payments being made? If so, is one legitimate and the other being taken by an employee?
 - (6) Is your signature on all checks authentic? DO NOT use signature stamps.
- (f) Randomly review bank statements that are delivered to you unopened to make sure that none are missing. Personally obtain and review any missing bank statements and also any checks that have been outstanding for a long time or which are missing.

D. Exercising Control Over Employees

1. Hiring

Just as an eviction action is no substitute for finding a good tenant, so too a lawsuit or criminal action is not much solace for hiring a dishonest employee. There is no substitute for hiring good, honest employees. While there are no guarantees on new employees, there are basic steps that should be taken. It is most important to do a thorough background review and to check references. One law firm hired a bright, attractive secretary who had excellent skills. They later fired her for stealing \$26,000 and only then inquired of her former employer to find out she had previously been fired from that firm and criminally prosecuted for theft.

2. Instruction

Lawyers are ethically obligated under RPC 5.3 to properly instruct and oversee employees to ensure that their actions are compatible with the lawyer's professional obligations. This is particularly true of those employees who will be involved with the handling of clients' and firm funds. Give them a copy of the Rules and this manual and make sure they understand the basics. Then follow up periodically and check their compliance.

3. Supervision

A partner in a law firm, and a lawyer who individually or together with other lawyers possesses comparable managerial authority in a law firm, shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that all lawyers in the firm conform to the Rules of Professional Conduct. A lawyer having direct supervisory authority over another lawyer shall make reasonable efforts to ensure that the other lawyer conforms to the Rules of Professional Conduct. RPC 5.1(a)(b).

With respect to a nonlawyer employed or retained by or associated with a lawyer, a partner, and a lawyer who individually or together with other lawyers possesses comparable managerial authority in a law firm, shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that the nonlawyer's conduct is compatible with the professional obligations of the lawyer. RPC 5.3(a).

E. Process

It is essential that all law firms develop a sound, routine process for handling checks that any deviations will serve to highlight questionable practices. Key among these processes are:

- Use restrictive endorsements on all checks received, marked "for deposit only" into a specific account or accounts.
- Require two signatures for large checks.
- Never use a facsimile signature stamp.

- Never write trust account checks to cash.
- Never use an ATM card to withdraw trust funds.

F. Billing Clients Regularly

One of the quickest ways to determine whether or not fees paid by clients for legal services (as well as other monies paid to the law firm on the client's behalf) have been handled improperly, is to bill clients promptly. If money is diverted to other purposes by law firm staff and is not correctly reflected on the bill, the client will be the first to complain. For this reason, many lawyers also account to clients more frequently than they are otherwise obligated to do.

G. Separate Trust Accounts For Lawyers in Same Firm

There is no limit to the number of client trust accounts that may be maintained by a lawyer or law firm. There is also nothing that prohibits each lawyer in a firm from maintaining trust accounts in the lawyer's own name separate from the firm. However, for good control, oversight and accountability, firm accounts are preferable to individual accounts. When individual partners or shareholders have separate trust accounts, they unnecessarily expose other principals to liability, usually without the other principals having any ability to exercise oversight or control over the handling of clients' funds in the separate accounts.

H. Insurance—The Ultimate Control

The ultimate risk control mechanism is insurance. Despite all prudent audit control steps one may take, it is still possible that a theft may occur. If reasonable audit control steps have been followed, however, such a theft will be detected at an early time and, hopefully, while the amount of money taken is small. Nevertheless, in a time where typical mortgage amounts run from \$100,000 to \$400,000, just one theft can expose the lawyer to tremendous financial risk.

Insurance may be the key to avoiding liability for theft by another lawyer or employee in the firm. Malpractice insurance policies usually have a standard exclusion relating to criminal, fraudulent and dishonest conduct of an insured. However, many also contain an "Innocent Insured Exception" to this inclusion. Some companies writing lawyer malpractice policies have a standard provision in its "claims made" policy that, in effect, covers each and every insured who did not personally commit, participate or acquiesce in the criminal, dishonest, fraudulent or malicious act, or remain passive after having personal knowledge of such act.

Under this policy an "innocent" lawyer partner, shareholder or sole practitioner would not be faced with declaring personal bankruptcy if another lawyer in the firm stole \$800,000 as the result of a gambling, drug or alcohol problem. Every lawyer should inquire into the feasibility of having the firm's malpractice policy contain this "innocent" lawyer exception. Lawyers should also inquire about the cost of "Dishonest Employee" coverage for non-lawyer staff members who handle trust and business funds.

Section 11: Interest On Lawyers Trust Accounts - IOLTA

A. What is IOLTA?

“IOLTA” (Interest On Lawyers’ Trust Accounts) is a method of raising funds through interest earned on the aggregate balance in a lawyer or law firm trust (or escrow) account. A trust account’s participation in IOLTA does not alter a lawyer’s determination of which funds should be held in trust, or the important rules regarding handling and accounting for them.

The IOLTA program was established by the Tennessee Supreme Court in 1984, and the responsibility for its administration was assigned to the Tennessee Bar Foundation. The purpose of the program is to raise funds to distribute to Tennessee organizations which provide direct legal services to the indigent, to organizations that seek to improve the administration of justice and to students, in the form of scholarships, at the state-supported law schools.

All lawyers practicing in Tennessee, who hold client or third party funds in a pooled trust (or escrow) checking account, must enroll those accounts in the Tennessee IOLTA program. The full obligations of lawyers (and the banks that choose to offer IOLTA accounts) are found in Rule of Professional Conduct 1.15 and Tenn. Sup. Ct. R. 43. As such, the IOLTA program functions as a partnership between the legal and financial communities.

B. How it Works

Lawyers routinely receive funds from clients to be held for future use. Funds too small in amount or held for too short a period of time to earn interest for the client, net of bank charges and administrative fees, are combined, or pooled, into trust accounts. Before the establishment of IOLTA programs (which now exist in all 50 states and the District of Columbia), funds held in this manner earned no interest. The advent of the IOLTA concept allowed interest to be paid on the aggregate balance in those accounts.

The lawyer’s responsibility is to enroll the account in the program at an Eligible financial institution. Once this step is properly accomplished, no further lawyer action is required. The financial institution calculates the interest earned, each month or quarter, and transmits that interest directly to the Foundation.

Frequently Asked Questions

1. IS PARTICIPATION IN IOLTA MANDATORY FOR LAWYERS AND LAW FIRMS THAT HOLD TRUST FUNDS?

Yes. Since January 1, 2010, a lawyer or law firm holding IOLTA-eligible funds must place those funds in an IOLTA account at an Eligible financial institution. The lawyer also must complete the IOLTA page of the Board of Professional Responsibility annual registration statement certifying

that an IOLTA-participating trust account is maintained and provide the bank name, account name and number.

2. DO THE IOLTA RULES AFFECT LAWYERS WHO DO NOT HOLD TRUST FUNDS?

Yes. All lawyers are required to complete the IOLTA page of the Board of Professional Responsibility annual registration statement. Lawyers not in private practice or those who do not hold trust funds are “exempt” from participation in IOLTA, BUT they must certify that status annually on the IOLTA page. For example, lawyers who work as a Judge, Attorney General, Public Defender, U.S. Attorney, District Attorney, in-house counsel, teacher of law, are on active duty in the armed forces or employed by state, local or federal government and not otherwise engaged in the private practice of law, are exempt. Lawyers who maintain a Tennessee license but practice law in another state are also exempt. The IOLTA page of the registration statement, which EVERY lawyer must complete, provides check boxes for all exempt statuses.

3. WHAT ARE “IOLTA-ELIGIBLE” FUNDS?

Funds belonging to a client or third person are “IOLTA-eligible” if they cannot earn income for the benefit of the client or third person in excess of the costs incurred to secure and distribute such income to the client or third person. If so, the funds should be deposited in a lawyer or law firm IOLTA-participating trust account.

4. WHAT IS AN “ELIGIBLE” FINANCIAL INSTITUTION?

Eligible financial institutions are those that voluntarily offer IOLTA accounts and comply with the requirements of the Rules. The Foundation certifies financial institutions as “Eligible,” and the list is available on the Foundation website (www.tnbarfoundation.org). Among the requirements to be Eligible, a financial institution must pay interest on an IOLTA account at the highest rate it pays to its non-IOLTA customers -- when IOLTA accounts meet or exceed the same minimum balance or other account eligibility qualifications, if any.

5. HOW IS IOLTA HANDLED AT A LAW FIRM?

While each lawyer is required to comply with the IOLTA provisions of the Rules, members or associates of law firms may meet those requirements using accounts shared by some or all lawyers at the firm. Lawyers are not required to maintain individual IOLTA accounts.

6. HOW IS A TRUST ACCOUNT THAT PARTICIPATES IN THE IOLTA PROGRAM OPENED?

Lawyers/law firms should complete the form titled “Notice to Financial Institution” available on the Foundation website (www.tnbarfoundation.org) and visit an Eligible financial institution to establish the new account. A copy of the completed form should be forwarded to the Foundation once the account is established.

7. MAY LAWYERS DEPOSIT INDIVIDUAL CLIENT OR THIRD PARTY FUNDS IN ACCOUNTS WHICH PAY INTEREST TO BE PASSED ON TO THE CLIENT?

Yes. Lawyers are expected to establish separate, interest-bearing accounts for individual client or third party funds when the sum is large enough and/or the duration is long enough to justify the cost of opening, administering and closing the account. Any interest accrued becomes the property of the client or third party. Again, if the client or third party funds are not large enough or the duration is not long enough to earn income net of the costs associated with the account, then the funds must be placed in an IOLTA account at an Eligible financial institution.

8. WHO PAYS SERVICE CHARGES AND FEES ON ACCOUNTS PARTICIPATING IN IOLTA?

Rule 43 of the Rules of the Supreme Court defines allowable reasonable service charges that may be netted against the interest earned on IOLTA accounts. They are “(a) per check or electronic debit charges; (b) per deposit or electronic credit charges; (c) a fee in lieu of minimum balance; (d) FDIC insurance fees or FDIC account guarantee fees; (e) a sweep fee; and (f) a reasonable IOLTA account administrative fee.” Check printing charges, wire transfer fees, bank or certified checks, cash management fees and overdraft costs, etc., are the responsibility of and may be charged to the lawyer or law firm maintaining the account. Lawyers with questions regarding applicable account fees should contact the financial institution to request a service charge disclosure.

9. ARE THERE OTHER REASONS A LAWYER WOULD NOT NEED AN IOLTA ACCOUNT?

If the nature of a lawyer’s practice is such that no IOLTA-eligible funds would be held, a trust account need not be established. Lawyers who do not hold IOLTA funds are required to certify that status, using the check box, on the IOLTA page of the Board of Professional Responsibility annual registration statement.

10. HOW IS THE INTEREST USED BY THE FOUNDATION?

The interest earned on IOLTA accounts is granted annually to law-related service providers in Tennessee. These organizations apply and are selected through a competitive, multi-layered, review process. More information is available on the Foundation website (www.tnbarfoundation.org).

Section 12: Other Relevant Trust Account Topics

A. Abandoned Property/Funds

Three situations provide unsolvable problems for lawyers:

- Missing Owners—cases in which lawyers know to whom trust funds belong, but owners cannot be found;
- Unclaimed Trust Funds—cases in which lawyers know to whom trust funds belong, but the owners fail or refuse to claim them; and
- Unidentifiable Trust Funds—cases in which the ownership of trust funds has become impossible to determine due to the passage of time (e.g. the merging of firms).

Maintenance of these funds, like all small inactive balances, hinders the process, since these odd amounts of funds must be carried from month to month. RPC 1.15, Comment [14] provides a procedure for disposing of these funds. If the funds remain unidentified or unclaimed, or if the missing client cannot be found or will not accept the funds, the lawyer should forward the funds according to Tennessee Code Annotated §§ 6-29-101 to 66-29-204 (Uniform Disposition of Unclaimed Property Act).

There are several ways to address the problem of trust account checks that are not cashed for a significant period of time. Some lawyers print “Void After 90 Days,” on trust account checks to persuade payees not to hold the checks. The notation does not guarantee that the bank will not honor the check after 90 days. This issue should be addressed with the bank in advance. Other lawyers contact all recalcitrant payees who fail to negotiate a trust account check after a certain period of time (usually six to nine months). Certified mail should be used if warranted by the amount of the check. If the payee cannot be located or a reply is not received within a reasonable amount of time, a stop payment should be placed on the check. If a stop payment order is placed on a check, the check may still be cashed. The bank’s procedures for stop payment orders should be understood in advance. After payment is stopped on a check, the funds are noted as returned on the individual client ledger. If the lawyer believes the funds have been abandoned, the lawyer must follow the Tennessee Unclaimed Property Act.

B. Trust Account Overdraft Notification

All financial institutions, approved as depositories for client trust accounts, are required as a condition of such approval, to report to the Board of Professional Responsibility in the event any properly payable client trust account instrument is presented against insufficient funds, regardless whether the instrument was honored. Tenn. Sup. Ct. R. 9 § 35.

The primary purpose of overdraft notification is to detect serious trust account violations. It should be recognized that the creation of an overdraft, if adequately explained, does not per se indicate a misappropriation of clients’ trust funds. Overdrafts can arise from a number of causes, such as a bank encoding error or the failure to timely credit a deposit to the trust account. The purpose of

the overdraft notification procedure is, through documentation, to differentiate these situations from a situation where a lawyer is misappropriating client's trust funds.

Normal banking practice requires the financial institution to give notice to the lawyer simultaneously with the notice of overdraft to the Board of Professional Responsibility. Where there is no impropriety, the lawyer will be as interested as anyone in finding the cause for the overdraft as quickly as possible.

On receipt of the overdraft notice, the Board will communicate in writing with the lawyer or law firm, requesting a written, documented response that explains the overdraft within 10 business days of the lawyer's receipt of that letter. In many instances, the lawyer will already have communicated with the financial institution and will have determined and corrected the error resulting in the overdraft.

A written response by the lawyer is required to the Board's request. A failure to respond is serious and will result in the Board opening a disciplinary complaint and requesting the attorney's written response. The attorney's failure to respond to a disciplinary complaint will result in the Board petition the Supreme Court for the lawyer's temporary suspension. Most overdraft notices are handled by responses from the lawyer properly documenting the cause of the overdraft. If further information is necessary to supplement the lawyer's initial response, it will be requested.

One of the most frequent causes of overdrafts relates to a failure to **timely** deposit trust monies. Checks drawn against uncollected funds will cause an overdraft to be reported. However, if a deposit is not made so that the seller or realtor for example, presents a closing check, in a real estate matter, on a banking day prior to the deposit (assuming there are no other trust funds in the account), an overdraft has to occur. Several things can (and should) be done to prevent these overdrafts:

- deposit funds promptly so they are credited promptly, and
- do not issue a trust account check or make an electronic disbursement until you are sure the funds are collected, and
- if it is a limited risk deposit, make sure you have other funds available in case the check that is the deposit fails.

Some lawyers do not immediately reimburse the trust account when they discover the account was overdrawn due to an accounting error or when a deposited check is returned for insufficient funds. When such an inadvertent debit to the account is discovered, the lawyer is responsible for reimbursing the account. Reimbursement of the trust account should NOT be held in abeyance pending resolution of the error (e.g., by locating the party responsible for a bad check). Any delay in reimbursing the account may result in the use of other client funds to cover the shortage, which is not permitted (conversion).

C. Closing a Client Trust Bank Account

When you need to close your trust account for any reason, here are some tips to remember:

- Be sure that the account is reconciled such that all funds remaining correspond to specific clients and/or administrative funds.
- Check with your bank to determine whether there are any charges associated with closing the account. If there will be a fee, make sure that you have enough administrative funds on deposit in the account to cover the fee.
- Do not close the account until all outstanding checks have cleared.
- Shred the checkbook and deposit slips for the account once it is closed so that these documents will not be accidentally used in the future.
- Refer to RPC 1.15, Comment [14] if there is an amount of funds left in the trust account that you are unable to identify or if you are unable to locate a client.
- Refer to IRS Publication 651 regarding abandoned property.
- If you are closing the trust account to move it to a new banking institution, check to be sure that your new banking institution is qualified to offer IOLTA accounts, by going to www.tbpr.org or www.tnbarfoundation.org.
- If you are closing the trust account to move it to a new banking institution, be sure that your audit trail is not lost, i.e. all funds moved from the old trust account are clearly identified by client and transferred fully to the new trust account.
- Notify the Tennessee Bar Foundation with the new trust account banking information.

D. Death or Disability and the Client Trust Bank Account

Pursuant to Tenn. Sup. Ct. R. 9 § 29, the Board, the Tennessee Bar Association, or other local bar, any attorney or other interested person may commence a proceeding in chancery, circuit or probate court to appoint a receiver-attorney if...no partner, associate, executor or other responsible successor to the practice of the lawyer is known to exist, and...the lawyer has resigned, been suspended, disbarred or become incapacitated or disabled, or disappears or dies, or where other reasons requiring protection of the public are shown.

Pursuant to Tenn. Sup. Ct. R. 9 § 29.3(b), the order of appointment of the receiver-attorney shall make the receiver-attorney a necessary signatory and take custody of any account maintained by the respondent with such bank or financial institution.

Pursuant to Tenn. Sup. Ct. R. 9 § 29, the receiver-attorney shall deliver all client funds in the custody of the affected lawyer to the clients subject to retaining or charging liens if appropriate.

The necessary expenses and any compensation of a receiver-attorney shall, if possible, be paid by the affected lawyer or the affected lawyer's estate.

It is prudent for a lawyer to arrange for the administration of his or her client trust account in the event of the lawyer's death or disability. A prudent lawyer is well-advised to identify someone in advance of such a contingency who can assume such a responsibility, to develop a plan that covers both the contingencies of disability and death, and to incorporate plans for the administration of the client trust account into a broader plan for winding down the lawyer's affairs if either contingency occurs. See Tenn. Sup. Ct. R. 9 § 29.9.

Strictly from the perspective of complying with a lawyer's ethical responsibilities, a prudent lawyer should consider the following:

First, a lawyer should choose a means that is not only legally effective, but also fair to, and expeditious for the clients who are entitled to the funds in the account. That favors identifying and reaching agreement with an identified person who is willing to assume the responsibilities of administering the trust account, and not leaving it to a court later to find a suitable candidate. The lawyer also is ethically obligated to select someone whom the lawyer reasonably believes is competent to discharge those responsibilities. Consistent with this requirement, the designee should be a lawyer because the distribution of funds in a client trust account necessarily requires an understanding of, and accountability under RPC 1.15.

Second, a lawyer should plan for both death and disability. Making a provision in a will for the handling of a trust account may satisfy a lawyer's ethical obligations if he or she dies, but such provisions are useless in planning for possible disability. Similarly, granting a power of attorney to another lawyer might be an effective way to anticipate the possibility of disability, but it is an ineffective tool in planning for a lawyer's death because such a power automatically terminates upon the grantor's death.

Third, a lawyer's plans for the disposition of his or her client trust account should be made in concert with a broader plan for the disposition of the lawyer's practice in the event of his or her death or disability. Prudence dictates that arrangements should be made with another lawyer to notify clients of the lawyer's disability or death, and to review the lawyer's files for the limited purpose of determining whether any immediate action needs to be taken to protect those clients' legal interests. See, e.g., ABA Formal Op. 92-369.

Consistent with a lawyer's obligations under RPC 1.15, a prudent lawyer is well advised to develop such a plan to ensure that his or her clients' interests in the account are adequately safeguarded.

E. Fraud

Out of the blue, you receive an email from the representative of a potential foreign client, maybe from China. He flatteringly tells you – in pretty decent English -- that he is looking for a trustworthy lawyer in Tennessee to help his company with a collections issue. You – you! -- are the trustworthy lawyer he has found. Your charge: you would receive money from a debtor and

then transfer it to the potential foreign client. You might even be paid with a percentage of the money.

Sounds promising, right? Some easy money? And tempting, because who knows where this one job for an international client might lead.

You send a fee agreement to the representative. He maybe sends the agreement back, signed, and tells you that it's imperative that you wire the money as soon as possible after receiving it from the debtor. You promptly receive a check from the debtor and deposit it into your trust account. Being a diligent lawyer, you confirm with your bank that the money has been credited to your account, and you wire it as directed. And then a few days later, your bank tells you that the check wasn't legitimate. The bank has debited your trust account thousands of dollars.

You already know about the email scams in which a Nigerian government official allegedly needs your help to move money out of the country. You've probably received those emails and immediately - and rightly - disregarded them because they look so bogus. This new wave of check scams just looks less bogus, more legitimate, and targets lawyers. It has hit close to home, too. The Board of Professional Responsibility is aware of several Tennessee lawyers who have been approached by the scammers, and a few who have taken the bait.

The checks that scammers send you, whether they are personal checks or cashier's checks, look and feel real, and may even fool bank tellers. The checks may even be from a legitimate business or corporation, but may have been written fraudulently.

In another variant of the scam, no checks are involved. Instead, money is transferred directly from another account into your trust account. The other account is often the account of someone who fell for another scam. Once again, when the scam is discovered your bank will cancel the deposit. You will lose your other client's money and you could be charged with the crime of money-laundering.

The following is a compilation of online resources regarding fraud and scams:

The Office of the Comptroller of the Currency: www.occ.treas.gov

Fraud Resources: www.fraud.org

Internet Crime Complaint Center: www.ic3.gov

Federal Bureau of Investigation: www.fbi.gov

How these scams work

These scams work well for three reasons:

The scammer appears to send you "real" money - usually a cashier's check or certified check drawn on a U.S. bank (sometimes even a postal money order) - before asking you to wire or express-mail part or all of that money to the scammer or a third party. The scam relies on your belief that real cashier's and certified checks and postal money orders are more trustworthy than

personal checks. However, the counterfeit checks or money orders that the scammers send are very well made and tough to identify as fake.

The scam is initiated in response to a legitimate activity, such as offering legal services and legal representation. In the original versions of the Nigerian scam, the “offer” arrives unsolicited, in a letter, an email or a fax.

Once the scammer is in touch with you, he often will chat via email or phone, talking about the legal services he needs. He appears friendly, sincere and aboveboard. He works hard to win your trust, but appearing trustworthy is the con artist’s primary tool in getting you to act.

Specific red flags to keep in mind

You are asked to pay money out of your account. This is a five-star red flag. If you are asked to do this, run, don’t walk, away from the “deal.” The basic pattern of all the fake check scams is that the con artists will send you a “cashier’s” or “certified” check (or postal money order) to deposit into your account. Then they will give you a reason to quickly wire or express part or all of the money out of your account to them or to some third party they identify. Often the wired money is to go to a foreign country.

You are asked to act very quickly. The scammers don’t want you to have time to verify whether the cashier’s check or certified check is authentic or counterfeit or to wait for the check to clear. The scammers typically ask you to wire cash as quickly as possible. They know that their fakes are very professional and usually will pass an initial visual inspection at the financial institution taking the deposit. Some counterfeits are so good that it may take weeks to identify the check as counterfeit. At that point, you are left holding the bag: the scam artists have your money and you may even be suspected of fraud.

Fake check scammers often claim to be in another country. That makes it difficult, they say, for them to do business in the U.S. so they need your help to receive payments by checks on U.S. banks. Often you are asked to wire the funds out of the country.

The deal is too good to be true. This old, smart consumer advice holds true in these cases. If a “client” is eager, sight unseen, to enlist your legal services, smell a rat. If after a few emails or phone conversations, a “client” wants to hire you, slow down.

Avoiding the scam

Wait for a cashier’s or certified check to clear before using the money. Although your financial institution may quickly make funds available that you’ve deposited, or may tell you that the deposit has been credited to your account, that does not mean that the check is good or has cleared through the original issuing institution. That can take many days. Sometimes it can take weeks to discover a very good forgery, and the check won’t bounce until then. Therefore, verify the check with the issuing bank and then wait for final clearance. All it will take is one insufficient-funds check for your trust account to be in the red. And you know, of course, that banks have to report to the Board of Professional Responsibility when your trust account becomes overdrawn.

Don't be fooled into thinking that the company is real or legitimate just because its website looks good. Some of the sites run by scammers look extremely professional.

Know with whom you are dealing. The law generally assumes that you, not your financial institution, have the best knowledge of the person who gave you the check because you are dealing directly with them. Therefore, if you are dealing with a stranger, make sure you have that person's name address and phone number, then verify those independently using online directories. If the number or address in the directory is different, call the person using those numbers. You may have stumbled into an identity-theft situation and can help another consumer.

There is no legitimate reason for someone who is giving you money to ask you to wire money back. **Always insist that the check be in the exact amount or deal in cash. Emphasize that you prefer a check from a local bank or a national bank with a branch in your area.**

Your deposits are your responsibility. If you have deposited a check that then bounces, the bank will withdraw the original dollar amount credited to your trust account. If your trust account doesn't have enough money to cover the deduction, the bank may freeze your trust account or, worse, the bank may sue you to recover the funds. The problem for lawyers is that if you hold funds for clients or third parties, you have to hold it in your client trust account. As a result, in this scam, if you're complying with the ethical rules, you would have put the money into your trust account and then you're disbursing out of your trust account. If the check you deposit turns out to be fake, then you may have converted the other clients' funds in your account.

So what do you do if you've been ensnared in a scam?

If you've been scammed, call the Board of Professional Responsibility's Ethics Hotline (1-800-486-5714) and your bank for advice. If you find that you've taken a fake check, don't deposit it. If you want to report it, go to the website of the National Fraud Information Center, <http://www.fraud.org/>.

F. Credit Cards and IRS Section 6050W

If you accept debit or credit cards from clients, a new IRS rule could cause problems if you're not ready.

Starting January 1, 2013, attorneys who accept credit cards need to make sure that the names on their merchant accounts match the ones the IRS has on file. Some attorneys may have used abbreviations or acronyms when they opened their accounts. If there is not an EXACT match between the information provided to the credit card processing company and the information on file with the IRS, there may be serious consequences:

Beginning January 2013, the IRS will impose a 28% withholding penalty on all credit card transactions. That could include your IOLTA client trust account if the account isn't labeled properly.

Lawyers could also commit ethical violations if they are unable to gain access to client funds in IOLTA accounts by failing to take the proper precautions.

Most credit card companies notified merchant accounts about the change. Ultimately, however, it's your responsibility to make sure that the IRS has your correct information. Please take the following steps:

1. If you accept credit cards, contact your credit card processor to check the name on the account;
2. Make whatever changes are necessary to stay in compliance.

For more information on Section 6050W visit www.IRS.gov, call the Board's Ethics hotline (1-800-486-5714).

APPENDIX A: ETHICS OPINIONS

Editor's Note: Only those ethics opinions that provide the most pertinent, substantive and comprehensive advice are included below.

1. Formal Ethics Opinion 85-F-96

Inquiry is made concerning the ethical consequences of settlement negotiations which include provisions relating to attorney's fees.

2. Formal Ethics Opinion 85-F-96(a)

Inquiry is made concerning the ethical consequences of settlement negotiations which include provisions relating to attorney's fees.

3. Formal Ethics Opinion 86-F-106

Inquiry is made concerning the ethical consequences of settlement negotiations which include provisions relating to attorney's fees.

4. Formal Ethics Opinion 87-F-109

Inquiry is made concerning the ethical obligations of a lawyer in the handling of settlement proceeds on behalf of a personal injury client when the client objects to the payment of medical expenses.

5. Formal Ethics Opinion 89-F-121

The Mechanics of Trust Accounting.

6. Formal Ethics Opinion 92-F-128

Inquiry is made concerning the ethical/fiduciary responsibilities relating to retainer fees, advanced fees, advanced costs and expenses, flat fees, pre-paid fees, and nonrefundable retainer fees.

7. Formal Ethics Opinion 92-F-128(a)

Inquiry is made concerning the ethical/fiduciary responsibilities relating to retainer fees, advanced fees, advanced costs and expenses, flat fees, pre-paid fees, and nonrefundable retainer fees.

8. Formal Ethics Opinion 92-F-128(b)

Reconsideration of 92-F-128(a) relating to refundable and nonrefundable fees has been requested.

9. Formal Ethics Opinion 2010-F-154

Inquiry is made regarding the propriety of requesting or requiring plaintiff's attorney to enter into agreements or releases which require the attorney to ensure payment of medical bills or liens to indemnify and hold harmless any party being released.

BOARD OF PROFESSIONAL RESPONSIBILITY
OF THE
SUPREME COURT OF TENNESSEE

FORMAL ETHICS OPINION 85-F-96

Inquiry is made concerning the ethical consequences of settlement negotiations which include provisions relating to attorney's fees.

The subject of this inquiry arises with increased frequency following the advent of structured settlements, class actions and the Civil Rights Attorney's Fee Award Act of 1976, 72 U.S.C. Section 1988.

Formal Ethics Opinions 80-F-1, 80-F-1(a), 84-F-61 and 84-F-77 have addressed the matter relating to structured settlement. Formal Ethics Opinion 84-F-77 states:

There is a potential, if not an actual, conflict of interest between the attorney and client in every instance where structured settlements are discussed or considered as a settlement option. It is recognized that, in some instances, an immediate cash settlement would be more beneficial to the client, whereas the attorney may prefer to receive the payment of his attorney fee periodically; or, vice versa. The preferences of the attorney or client are often dependent or based upon their respective ages, economic station or tax consequences. These factors will seldom, if ever, be viewed from the same perspective by the attorney and the client.

Formal Ethics Opinion 80-F-1 states:

... any arrangement by which the opposing party participates in the setting of the fee charged by the attorney to his client conflicts with the language and intent of DR 5-107 and EC 5-22 of the Code. (emphasis added)

The matter of civil rights attorney's fee awards has not been addressed in a Formal Ethics Opinion. It appears the conflict in such instances may be more severe than in cases involving structured settlements. For example, in the case of *Jeff D. et al v. Evans*, 743 F.2d 648 (9th Cir. 1984), during the settlement negotiations, the defendants offered virtually all of the relief sought by plaintiff's conditioned upon waiver of attorney's fees by plaintiff's counsel.

The Ninth Circuit Court of Appeals in considering the matter states:

The crux of the problem is the possibility of diverging interests of the lawyer and the class. The attorney may be tempted with a generous fee offer as a quid pro quo for less than optimal settlement. Alternatively, the defendant may condition settlement on the attorney's waiver of fees, creating a particularly severe conflict when important interests of class members are at stake....

To avoid this conflict, this circuit has ... disapproved simultaneous negotiation of settlements and attorney's fees.

In such instances, settlement negotiations which include provisions for attorney's fees are not inherently improper and may be appropriate, provided plaintiff's counsel:

- (i) Fully advises the plaintiff or plaintiffs concerning each and every step and aspect of the negotiations;
- (ii) Advises that independent legal advice may be obtained regarding the matter; and
- (iii) The client should be allowed to approve or disapprove of the entire settlement, including provisions relating to attorney's fees. When consent, approval or permission of a court is required, the court should be fully advised of all matters relative thereto, including the provisions of attorney fees.

This 31st day of May, 1985.

ETHICS COMMITTEE:

W. J. Flippin, Chairman

Edwin C. Townsend

Henry H. Hancock

APPROVED AND ADOPTED BY THE BOARD

BOARD OF PROFESSIONAL RESPONSIBILITY
OF THE
SUPREME COURT OF TENNESSEE

FORMAL ETHICS OPINION 85-F-96(a)

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- (iii) The client should be allowed to approve or disapprove of the entire settlement, including provisions relating to attorney's fees. When consent, approval or permission of a court is required, the court should be fully advised of all matters relative thereto, including the provisions for attorney fees.

This 26th day of September, 1986.

ETHICS COMMITTEE:

W. J. Flippin, Chairman

Edwin C. Townsend

Henry H. Hancock

APPROVED AND ADOPTED BY THE BOARD

¹The District Court denied attorney's application for fees following a settlement agreement providing for a waiver of attorney's fees. The Ninth Circuit held that a stipulated waiver of attorney's fees obtained solely as a condition for obtaining relief for the class should not be accepted and the Court should make its own determination of reasonable fees, remanding the case for such a determination. The United States Supreme Court granted certiorari and, on April 21, 1986, held that the District Court had discretion to refuse to award fees, and considering the extent of relief in the settlement, there was no abuse of discretion by the District Court in upholding the waiver of fee and denying attorney's application for fees. See *Evans v. Jeff D.*, 106 S.Ct. 1531 (1986).

BOARD OF PROFESSIONAL RESPONSIBILITY
OF THE
SUPREME COURT OF TENNESSEE

FORMAL ETHICS OPINION 86-F-106

Inquiry is made concerning the attorney's retention of clients' documents in an effort to enforce resolution of a fee dispute between the attorney and client.

The Common law recognizes an attorney's lien on client's documents to secure payment of legal fees. See McDonald, Shea & Co. v. Railroad, 93 Tenn. 281 (1893) and Brown & Reid v. Bagley, 3 Tenn. Ch., 621 (1878).

American Bar Association Formal Ethics Opinion 209 states,

Any question as to the amount of an attorney's fee or method of its payment is a matter of contract, expressed or implied to be construed. Any controversy concerning such a matter is a matter of law to be determined by the Courts. Ordinarily no ethical question is involved in such a controversy.

This opinion will attempt to address some of the ethical obligations and concerns which may occasionally arise from such matters.

Disciplinary Rules 2-106(A) and (B) of the Code of Professional Responsibility prohibit illegal or clearly excessive fees for legal services.

Disciplinary Rule 2-110(A)(2) of the Code requires a lawyer, upon withdrawal from representation, to take reasonable steps to avoid foreseeable prejudice to the rights of his client and to deliver all papers and property.

Disciplinary Rule 7-101(A)(3) states that a lawyer shall not prejudice or damage his client.

Disciplinary Rule 9-102(B)(4) requires the lawyer to promptly deliver to the client the property in the lawyer's possession which the client is entitled to receive.

Pursuant to the Preliminary Statement of the Code of Professional Responsibility the above cited Disciplinary Rules are mandatory and,

state the minimum level of conduct below which no lawyer can fall without being subject to disciplinary action.

Some of the applicable Ethical Considerations of the Code of Professional Responsibility which provide aspirational objectives and constitute a body of principles for guidance in this matter are as follows:

EC 2-16 The legal profession cannot remain a viable force in fulfilling its role in our society unless its members receive adequate compensation for services rendered, and reasonable fees should be charged in appropriate cases to clients able to pay them.

Nevertheless, persons unable to pay all or a portion of a reasonable fee should be able to obtain necessary legal services, and lawyers should support and participate in ethical activities to achieve that objective.

EC 2-23 A lawyer should be zealous in his efforts to avoid controversies over fees with clients and should attempt to resolve amicably any differences on the subject. He should not sue a client for a fee unless necessary to prevent fraud or gross imposition by the client.

EC 2-25 The basic responsibility for providing legal services for those unable to pay ultimately rests upon the individual lawyer, and personal involvement in the problems of the disadvantaged can be one of the most rewarding experiences in the life of a lawyer. Every lawyer, regardless of professional prominence or professional workload, should find time to participate in serving the disadvantaged. The rendition of free legal services to those unable to pay reasonable fees continues to be an obligation of each lawyer, ---

EC 2-32 ---Even when he justifiably withdraws, a lawyer should protect the welfare of this client by
---delivering to the client all papers and property to which the client is entitled. ---and otherwise endeavoring to minimize the possibility of harm.

EC 5-1 The professional judgment of a lawyer should be exercised, within the bounds of the law, solely for the benefit of his client and free of compromising influences and loyalties. Neither his personal interests, the interests of other clients, nor the desires of third persons should be permitted to dilute his loyalty to his client.

EC 5-2 A lawyer should not accept proffered employment if his personal interests or desires will, or there is a reasonable probability that they will, affect adversely the advice to be given or services to be rendered the prospective client. After accepting employment, a lawyer carefully should refrain from acquiring a property right or assuming a position that would tend to make his judgment less protective of the interests of his client.

It therefore appears that there may be instances where there are mixed questions of legal and ethical concern. In such instances the ethical obligations of the attorney should prevail. For example, it is

unethical for an attorney to assert a lien for legal services which is illegal or clearly excessive.

Prior to asserting a lien on the client's property for payment of legal services the attorney should seek all other reasonable means of collection, including suggesting that the client place funds for disputed claims in escrow with a third party, pending the proper adjudication of the matter. The attorney's lien should only be asserted as a last resort when necessary to prevent fraud or gross imposition by the client.

The case of Crawford v. Logan, 656 S.W.2d 360 (Tenn. 1983), wherein the attorney did not assert a lien but instead withheld a portion of the file which the client did not know existed has been fully considered and this opinion does not conflict with the holding of the Supreme Court therein.

This 26th day of September, 1986.

ETHICS COMMITTEE:

Jerry C. Colley

William R. Willis

Cecil D. Branstetter

APPROVED AND ADOPTED BY THE BOARD

BOARD OF PROFESSIONAL RESPONSIBILITY
OF THE
SUPREME COURT OF TENNESSEE

FORMAL ETHICS OPINION 87-F-109

Inquiry is made concerning the ethical obligations of a lawyer in the handling of settlement proceeds on behalf of a personal injury client when the client objects to the payment of medical expenses.

A lawyer should hold property of others with the care required of a professional fiduciary. Disciplinary Rule 9-102 of the Code of Professional Responsibility requires the lawyer to keep funds of the client in an identifiable bank account, maintain complete records thereon, render appropriate accounts to the client, and promptly pay and deliver to the client the funds which the client is entitled to receive.

Disciplinary Rule 7-102 of the Code prohibits the lawyer from assisting the client in fraudulent conduct. DR 7-102(B)(1) specifically requires the attorney to counsel the client against perpetration of a fraud upon another and, if the client insists on fraudulent conduct, to reveal the potential fraud to the affected person. The client has no privilege of confidentiality with respect to proposed fraudulent activity. See DR 4-101.

There is no clear ascertainable ethical authority concerning the lawyers ethical duties when there is a dispute between the client and third-party concerning the right to funds held by the lawyer on behalf of the client. The Idaho Supreme Court in the case of *Bonanza Motors Inc. v. Webb*, 104 Idaho 234, 657 P2d 1102 (1983) in a legal issue held that a lawyer must not deliver funds to a client when the lawyer has notice that a third-party has a superior right to the funds. The lawyer was found liable in an action by the creditor when the lawyer paid the entire judgment to the client after having received a copy of an instrument by which the client had assigned part of his judgment award to a third-party creditor, and provided that the lawyer should pay the creditor directly when the funds were received.

This ethics opinion holds that a lawyer who has notice that a creditor of the client has a lien or assignment to the funds held on behalf of the client is ethically obligated to segregate and retain the disputed funds until the dispute is resolved. Payment of the disputed amount into court for a resolution of the matter is permissible after the parties have had a reasonable opportunity to resolve the dispute.

This 16th day of September, 1987.

ETHICS COMMITTEE:

W. J. Flippin

Henry H. Hancock

Edwin C. Townsend

APPROVED AND ADOPTED BY THE BOARD

BOARD OF PROFESSIONAL RESPONSIBILITY
OF THE
SUPREME COURT OF TENNESSEE

FORMAL ETHICS OPINION 89-F-121

THE MECHANICS
OF
TRUST ACCOUNTING

The Board issues this Formal Ethics Opinion on the Mechanics of Trust Accounting for the consideration of members of the Tennessee Bar by adopting the following portions of a treatise on Trust and Business Accounting for Attorneys, Second Edition, 1988, by David E. Johnson, Jr., Esquire, Director, Office of Attorney Ethics of the Supreme Court of New Jersey, as follows:

...In most states, whether by rule, statute or case law, attorneys are simply admonished to account in accordance with generally accepted accounting practices. Most attorneys, however, are not accountants and so this general direction, without more, leaves much to be desired.

...(C)omplete compliance with trust accounting duties requires familiarity with only four items:

- A. Trust Checkbook...
- B. Trust Receipts Book...
- C. Trust Disbursements...
- D. Client Trust Ledger Book...

A. Trust Checkbook

This is the most familiar of the trust accounting documents. It is, as it says, simply a form of checkbook. It may be identical in form to a personal checkbook, and anyone who can properly keep a personal checkbook can easily maintain a trust checkbook....

There are two parts to the checkbook itself: the checks and the stub. The check itself is self-explanatory. All checks must be pre-numbered. The stub is a miniature accounting sheet which, given a correct beginning balance, allows you to add-in the amount of all deposits and to subtract-out the amount of all the checks (and bank fees), giving you a new correct running balance. For those who like to look at these things horizontally, instead of vertically as the stubs are produced, the information would look like this:

Date	Description of Client or Matter	Deposits (ADD)	Check (Subtract)	Running Balance
5/2/1987	John Smith	\$5,000		\$17,500
5/13/1987	Rebecca Sands		\$3,200	\$14,300
5/20/1987	John Smith		\$1,300	\$13,000
5/20/1987	John Smith		\$3,700	\$ 9,300
5/21/1987	Burtol Corp	\$2,000		\$11,300

Monies come into the trust account via deposits, either by the lawyer or by the financial institution. If the attorney deposits the money, a deposit slip... will be completed by filling out the date, amount, client's last name or file number (to protect client confidentiality) and the source of the deposit by recording the bank identification code number of the check that is being deposited. These codes are found at the upper right-hand corner of a check. They are an identification code developed by the American Banker's Association and enable anyone with the code tables to locate the bank on which the check is drawn very accurately.

Some deposit slips are carbonized and the carbon portion, called the duplicate deposit slip, is returned to the attorney by the teller at the time the deposit is made. If carbonized deposit slips are not used, the teller will give the attorney a receipt showing the day, time and amount of the deposit. In this case it is important to record right on the receipt, the client's name or file number and the source bank code of the check that was deposited.

Deposits may also be made by the bank issuing a memorandum (a/k/a credit memo) showing the date, amount and source of the monies so deposited... This is the case where a client wires money directly from her account to the attorney's account.

Monies may be disbursed (a/k/a withdrawn), either by the attorney or the financial institution. Checks written on a trust account are identical to other checks... Checks, like deposits, must list the date and client or legal matter (i.e., purpose). As a corollary to the source, which is required to be noted on the deposit ticket, every check must show the payee.

As with deposits, withdrawals can be made by the financial institution issuing a memorandum (a/k/a debit memo)... Thus, for example, where funds are wired from your account to that of your client in California, your financial institution will issue a memorandum advising the date, amount and source of the monies so transmitted. Debit memos are also issued for service items such as (a) cost of wire transfers, (b) monthly service charges, (c) overdraft notices, (d) check printing charges, (e) returned item notices, and other services rendered to you for which a fee is charged....

That is all there is to handling a trust account checkbook! It is really no different from handling a personal checking account. Three rules, however, make it work. First, all entries (deposits and disbursements) should be recorded contemporaneously (within 24 hours of the event). Second, all entries must be exact, to the penny. There is no room for rounding-off figures. This may be tolerable for personal accounts, but is definitely not acceptable for a trust account. Third, you must always keep a running balance preferably after each deposit or disbursement. ...

B. and C. Trust Receipts and Disbursements Books

While these items sound foreboding to some, they are in fact much less complicated than the trust checkbook. In fact the Trust Receipts Book is nothing more than a chronological listing of every deposit made to the trust account. Conceptually, a yellow legal pad would serve the purpose! From the point of view of generally accepted accounting practice, however, a bound book (or journal) which gives these records some permanency is the required form. ...Note that it contains the exact same information required to be maintained in the trust checkbook stub and on the deposit slip or receipt itself, namely:

- (a) date;
- (b) source;
- (c) client name or matter; and (d) amount.

Similarly, the Trust Disbursements Book is a chronological listing of every disbursement made from the trust account. ...It contains the identical information required to be recorded on the trust checkbook stub and on the check (or a debit memorandum) itself, namely:

- (a) date;
- (b) payee;
- (c) purpose; and
- (d) amount.

In defining a Trust Receipts Book I stated that it must contain a chronological list of each and every deposit. This includes all credit memos from the financial institutions. ...Similarly, the Trust Disbursements Book must reflect each and every disbursement including any debit memos received...

At the end of each month, the total of all monies received should be added up as reflected in the Trust Receipts Book. Likewise, the total of all disbursements must be added as shown in the Trust Disbursements Book. These monthly totals should then be placed on the Control Sheet. ...(T)he Control Sheet is one of the first steps in the reconciliation process and filling out the Control Sheet monthly puts you a step ahead in the reconciliation process.

But why record the same information twice, you might ask? Why record all the same information you included in writing out a check in a Trust Disbursements Book? Good question! There are several reasons.

The first relates back to...maintaining an audit trail. The deposit slips, receipts, checks and memoranda are all referred to as source documents. They are the documents which actually "move" money around. Therefore, they must reflect the descriptive information above so they provide a complete audit trail, a direct link, to the trust receipts and disbursements books and to the clients' ledger book which will be covered next. But they are not permanent records. Recording their information in receipts and disbursements books, however, gives them permanency and accords with generally accepted accounting practice. ...

The other reasons relate to the purposes for the trust receipts and disbursements books, which are three-fold. First and foremost these two records, under the commonly used double-entry bookkeeping method, permit you to double check the running balance in the trust account to make sure it is correct...

The second purpose which these two books serve is an easily accessible means of locating items by arranging all deposits together chronologically in one book, and all disbursements together chronologically in another book. This is particularly handy at reconciliation time when a transposition error has occurred. In short, it makes it easy to find mathematical errors chronologically. Finally, and this is very important to realize, trust receipts and disbursements books allow you to look at your trust account activity on a macro-level. Add up all of the deposits listed in your trust receipts book for a particular month (or year) and see how much trust money you took in during that period. Similarly, add up all the disbursements in your trust disbursements book for a year (or a month) and see how much trust money went out during that period. Add the amount of deposits to the amount of disbursements for a given period, say one year, and you can tell the total amount of client funds for which you were responsible.

All of the three records that have been discussed so far--the Trust Checkbook, Trust Receipts Book and Trust Disbursements Book--give the "big picture," the overview. However, while this is very important, it is at least equally important to know, at any given time, exactly how each client's funds stand. This can be ascertained by the fourth and final item -- the Clients' Trust Ledger.

D. Clients' Trust Ledger Book

...(S)eparate clients are separate accounts. Indeed, this is the foundation of trust accounting, maintaining the individual separation and control that each client has the right to expect.

In order to maintain this full control and separate accountability of each individual client's trust funds, we maintain an individual accounting record of every deposit to and disbursement from that particular client's account. We do so by maintaining a separate book, called a Clients' Trust Ledger, with a separate page for each trust client.

The concept of an appropriate ledger book ... contemplates an integrated record which will show the current status of all funds collected or received for the credit of a particular client or beneficiary, all payments out and the amount, if any, remaining due the client. ...The Client Trust Ledger Book itself may be either bound or loose leaf, with removable ledger sheets which may be taken out when the client matter is closed. Original closed ledger sheets should not, however, be placed in the closed case file where they will be lost forever unless the name of the client is recalled. While a photocopy of the closed ledger sheet may properly be placed in the individual client case file, the original should be placed in a closed three ring binder and arranged alphabetically for future reference.

A separate client ledger sheet must... be maintained for each separate trust client. Thus, an entirely separate page must be set up for each client, regardless of the fact that all funds coming into the attorney's hands are disbursed simultaneously. This situation commonly occurs, for example, in real estate transactions. Good record keeping practices indicate that the reverse side of a ledger sheet should also be reserved for the sole use of that single client. Do not use the reverse side of one client's ledger for another client's case. Likewise, where a single client has multiple matters being handled by the same attorney, each separate financial matter should be reflected on a separate client ledger sheet.

...Like the trust account checkbook, a running balance on each individual client ledger sheet is maintained. This is so because we must NEVER disburse more money than we have on hand (collected)

to the credit of that individual client. Keeping a running balance permits the attorney to know this at a glance.

Also, note the descriptiveness of the client ledger sheet. ...It must reflect:

- (1) the source of funds deposited;
- (2) the names of all persons (i.e., clients) for whom funds are or were held;
- (3) the amount of such funds;
- (4) the description and amounts of all charges or withdrawals (i.e., disbursements) from such accounts;
- (5) the names of all persons to whom funds were disbursed.

Putting It All Together

We have separately looked at each of the four items that comprise the basics of correct attorney trust accounting. They are:

- A. Trust Checkbook;
- B. Trust Receipts Book;
- C. Trust Disbursements Book; and
- D. Clients' Trust Ledger Book.

Now we shall see how they fit together to form an integrated accounting system.

...(A)s a deposit comes in, say a settlement in a negligence matter, the check is received by the attorney (Step 1). The attorney then prepares a source document, which is a deposit slip (Step 2), and physically makes the deposit and has the duplicate deposit slip returned, stamped received with the date. This information is then entered in the trust checkbook (Step 2). Next, the deposit information is entered chronologically in the Trust Receipts Book (Step 3) and is also recorded on the individual client's trust ledger (Step 4).

Set forth below is a simple key to show the trust documents on which deposit and disbursement information must be recorded.

TRUST ENTRY KEY

<u>DISBURSEMENTS</u>	<u>TRUST RECORDS</u>	<u>ENTER DEPOSITS</u>	<u>ENTER</u>
A.	Trust Checkbook	X	X
B.	Trust Receipts Book	X	
C.	Trust Disbursements Book		X
D.	Clients' Trust Ledger	X	X

Reconciliation -- The 3-Way Check

Everybody makes mistakes when it comes to figures. Even banks and accountants make mistakes on occasion. This should not be surprising because there are a lot of ways that mistakes can be made. Simple arithmetic mistakes in addition or subtraction are common. Transposition errors occur when our eye rearranges the sequence of numbers and we record \$122.92 when the correct figure is \$129.22. In a similar vein, banks, which process checks and deposits electronically overnight by the millions, will sometimes have an encoding error when one of its coders reads a \$1,000 check but encodes the amount at the bottom right-hand corner as \$10,000. Other errors which may occur run the gamut from simply skipping one of many lines while transferring figures from one list to another, to perhaps the simplest mistake of all -- forgetting to record a check or deposit at all.

A reconciliation allows the attorney to detect when an error has occurred by showing that items, which should balance, do not balance. Our record keeping rule (and generally accepted accounting practice) requires that a reconciliation be performed at least quarterly.

...Naturally, the more frequently an account is reconciled, the sooner one will be able to detect, and thus correct, an error. The best rule is to reconcile monthly. Copies of all records reflecting quarterly reconciliations must be retained.

Reconciliation is the process by which all required trust records are brought into agreement. More simply, perhaps, it represents a balancing process by which the trust account records are all brought into a state of equilibrium. Based upon our model double-entry bookkeeping system, a full reconciliation requires a three-step review and analysis of the four documents.... By this process:

- (1) the balance of all trust receipts and disbursements is reconciled to the total of individual client ledger balances on hand;
- (2) the total of individual client ledger balances on hand is then reconciled to the trust checkbook balance; and finally,
- (3) the trust checkbook balance (as adjusted) is then reconciled with the balance on the trust bank account statement.

STEP NO. 1

The very first step in the reconciliation process is to obtain a correct beginning balance. You can never reconcile an account unless you know the correct balance which you should have on hand to start with. When a new trust account is opened, the first time the account is reconciled the beginning balance will be zero. The beginning balance for each succeeding period for which a reconciliation is prepared will necessarily depend upon the prior reconciled balance being correct. This requires any discovered errors to be resolved. If you are not sure that the beginning trust balance is correct, you should consult a bookkeeper or an accountant. Carrying an incorrect balance only compounds the problem, as time makes finding and correcting the errors more and more difficult.

STEP NO. 2

The second step in the reconciliation process is to add up all items for the reconciliation period (i.e., month or quarter) that have been recorded in the Trust Receipts Book.... The same total is then compiled for the Trust Disbursement Book.... Both of these figures are placed on the Receipts/Disbursements Control Sheet..., together with the beginning balance. The total of trust funds received is then added to the beginning balance. From the resulting figure, the total of trust funds disbursed is subtracted. This results in a new balance figure. It is this figure which will form the bedrock of the reconciliation process. That figure is also placed in the appropriate place on the Trust Reconciliation Sheet.

STEP NO. 3

Next, prepare a list of the names and balances on hand (as of the bank statement date) for all trust clients and place them in the appropriate location on the Trust Reconciliation Sheet. These client figures are obtained by taking the last running balance from each individual Client's Trust Ledger Sheet and inserting the total of all individual ledger balances in the appropriate place on the Trust Reconciliation Sheet. (If there are many clients, a separate schedule of clients' ledger balances should be made.)

STEP NO. 4

Compare the Control Sheet Balance to the total Clients' Trust Ledger Balance. They must be equal...

STEP NO. 5

Place the amount of the checkbook balance in the Trust Checkbook in the appropriate place on the Trust Reconciliation Sheet. Compare the amount of the Total Clients' Ledger Balance to the balance in the Trust Checkbook. They must be equal.

STEP NO. 6

List all outstanding checks and outstanding deposits (also called deposits in transit) on the Trust Reconciliation Sheet that are not reflected on the latest monthly bank statement for the reconciliation period. Add the outstanding checks to the Trust Checkbook Balance and place that amount in the place indicated on the Trust Reconciliation Sheet. Subtract from that figure all outstanding deposits and place that amount opposite the entry titled "Reconciliation Balance." Insert the Bank Statement Balance on the Trust Reconciliation Sheet.

STEP NO. 7

Compare the Reconciliation Balance to the Bank Statement Balance - they must be equal.

Congratulations, if both figures are equal! If they are you have successfully, and correctly, reconciled your trust account. If there is a difference between the two figures roll up your sleeves, call in your bookkeeper or check with an accountant. Whatever you do, do not do nothing. Figures which do not reconcile only get harder to reconcile with time.

This 9th day of December, 1989.

ETHICS COMMITTEE:

/s/ Kitty G. Grubb

/s/ Michael E. Callaway

/s/ Charles T. Herndon, III

APPROVED AND ADOPTED BY THE BOARD

**BOARD OF PROFESSIONAL RESPONSIBILITY
OF THE
SUPREME COURT OF TENNESSEE**

FORMAL ETHICS OPINION 92-F-128

Inquiry is made concerning the ethical/fiduciary responsibilities relating to retainer fees, advanced fees, advanced costs and expenses, flat fees, pre-paid fees, and nonrefundable retainer fees.

Ethical Consideration 2-19 of the Code of Professional Responsibility states:

EC 2-19

As soon as feasible after a lawyer has been employed, it is desirable that he reach a clear agreement with his client as to the basis of the fee charges to be made. Such a course will not only prevent later misunderstanding but will also work for good relations between the lawyer and the client. It is usually beneficial to reduce to writing the understanding of the parties regarding the fee, particularly when it is contingent. A lawyer should be mindful that many persons who desire to employ him may have had little or no experience with fee charges of lawyers, and for this reason he should explain fully to such persons the reasons for the particular fee arrangement he proposes.

Disciplinary Rule 9-102(A) of the Code states, in part;

DR 9-102. Preserving Identity of Funds and Property of a Client.

(A) All funds of clients paid to a lawyer or law firm, including advances for costs and expenses, shall be deposited in one or more identifiable insured depository institutions maintained in the state in which the law office is situated.

...No funds belonging to the lawyer or law firm shall be deposited therein except as follows:

- (1) Funds reasonably sufficient to pay service charges may be deposited therein;

- (2) Funds belonging in part to a client and in part presently or potentially to the lawyer or law firm must be deposited therein, but the portion belonging to the lawyer or law firm may be withdrawn when due unless the right of the lawyer or law firm to receive it is disputed by the client, in which event the disputed portion shall not be withdrawn until the dispute is finally resolved.
- (B) A lawyer shall:
- (1) Promptly notify a client of the receipt of ...funds, securities, or other properties.
 - (2) Identify and label securities and properties of a client promptly upon receipt and place them in a safe deposit box or other place of safekeeping as soon as practicable.
 - (3) Maintain complete records of all funds, securities and other properties of a client coming into the possession of the lawyer and render appropriate accounts to (the) client regarding them.
 - (4) Promptly pay or deliver to the client as requested by a client the funds, securities or other properties in the possession of the lawyer which the client is entitled to receive.

All unearned attorney fees of any kind or nature paid by or on behalf of a client to an attorney, including retainer fees, advanced fees, general retainers, special retainers, flat fees, pre-paid fees, etc.; including advanced costs and expenses; are funds which belong in part to the client and must be deposited in a trust account to be withdrawn only when due, unless the right of the attorney or other payee to receive funds is disputed by the client, in which event the disputed portion shall not be withdrawn until the dispute is finally resolved.

The same fiduciary duties described above are applicable to non-monetary property delivered to an attorney as security for unearned fees. Such security deposits are required to be placed in trust and safekeeping.

In limited instances an attorney may receive an advanced earned fee in the nature of an unrefundable retainer fee designed to compensate the attorney for being available to represent a client, or to compensate the attorney for committing time for representation precluding acceptance of other employment, or to compensate the attorney for being precluded from taking an adversary interest or position because of conflicting interests or for having received privileged information. Earned fees of this kind and nature do not have to be placed in trust accounts and are subject to the strict limitations of Disciplinary Rules 2-106(A) and (B) of the Code; and, pursuant to DR 2-110(A)(3), 2-110(B)(4) and other applicable legal authorities

may be subject to accountability and refunding in certain circumstances.¹

All pre-paid, advanced or retainer fees are ethically deemed to be refundable in the absence of a clear understanding by the client to the contrary, preferably in writing.

This 11th day of June, 1992.

ETHICS COMMITTEE:

Harris A. Gilbert

Donna Simpson Massa

Barbara J. Moss

APPROVED AND ADOPTED BY THE BOARD

¹It is not clear, however, whether a nonrefundable retainer would be valid. A client who has just paid a lawyer \$50,000 to perform all occupational health and safety work for a factory that burns down the next day, obviating the need for any legal work, can probably recover the retainer even if it was solemnly called "nonrefundable" in the agreement. Moreover, because the nonrefundable feature chills the client's right to discharge the lawyer ..., it has been held that such a clause is invalid and the lawyer is only entitled to the reasonable value of his or her services after discharge. See Modern Legal Ethics, Wolfram p. 506; Jacobson v. Sassower, 122 Misc.2d 863, 474 N.Y.S.2d 167 (1983), affirmed 107 A.D.2d 603; 483 N.Y.S.2d 711 (1985).

BOARD OF PROFESSIONAL RESPONSIBILITY
OF THE
SUPREME COURT OF TENNESSEE

FORMAL ETHICS OPINION 92-F-128(a)

Inquiry is made concerning the ethical/fiduciary responsibilities relating to retainer fees, advanced fees, advanced costs and expenses, flat fees, pre-paid fees, and nonrefundable retainer fees.

Ethical Consideration 2-19 of the Code of Professional Responsibility states:

EC 2-19

As soon as feasible after a lawyer has been employed, it is desirable that he reach a clear agreement with his client as to the basis of the fee charges to be made. Such a course will not only prevent later misunderstanding but will also work for good relations between the lawyer and the client. It is usually beneficial to reduce to writing the understanding of the parties regarding the fee, particularly when it is contingent. A lawyer should be mindful that many persons who desire to employ him may have had little or no experience with fee charges of lawyers, and for this reason he should explain fully to such persons the reasons for the particular fee arrangement he proposes.

Disciplinary Rule 9-102(A) of the Code states, in part:

DR 9-102 - Preserving Identity of Funds and Property Of A Client

- (A) All funds of clients paid to a lawyer or law firm, including advances for costs and expenses, shall be deposited in one or more identifiable insured depository institutions maintained in the state in which the law office is situated.

...No funds belonging to the lawyer or law firm shall be deposited therein except as follows:

- (1) Funds reasonably sufficient to pay services charges may be deposited therein:

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

- (8) A lawyer shall:
 - (1) Promptly notify a client of the receipt of his funds, securities, or other properties.
 - (2) Identify and label securities and properties of a client promptly upon receipt and place them in a safety deposit box or other place of safekeeping as soon as practical.
 - (3) Maintain complete records of all funds, securities and other properties of a client coming into the possession of the lawyer and render appropriate accounts to his client regarding them.
 - (4) Promptly pay or deliver to the client as requested by a client the funds, securities or other properties in the possession of the lawyer which the client is entitled to receive.

Advanced fees or flat fees may be earned fees or unearned fees, depending upon the circumstances.

All unearned attorney fees of any kind or nature paid by or on behalf of a client to an attorney are funds which belong in part to the client. These unearned attorney fees include retainer fees, unearned advanced fees, general retainers, special retainers, flat fees, pre-paid fees, etc. These funds must be deposited in a trust account to be withdrawn only when due, unless the right of the attorney or other payee to receive funds is disputed by the client. In the event of a dispute, the disputed portion shall not be withdrawn until the dispute is resolved.

The same fiduciary duties described above are applicable to non-monetary property delivered to an attorney as security for unearned fees. Such security deposits are required to be placed in trust and safekeeping.

All earned fees belong solely to the attorney and need not be placed in a trust account. An attorney may receive an advanced earned fee in the nature of an unrefundable retainer fee in the following limited instances: (1) to compensate the attorney for being available to represent a client, (2) to compensate the attorney for committing time for representation precluding

acceptance of other employment, (3) to compensate the attorney for being precluded from taking an adversary interest or position because of conflicting interests or because of the receipt of privileged information. Advanced fees or flat fees involving criminal law, domestic or family law or juvenile law may be earned fees. Fees for routine legal services completed and fully delivered to the client within a reasonable period of time may be earned fees. Routine legal services may include wills, trusts, contracts, notes, deeds, tax returns, opinion letters or other such matters. Earned fees of this kind and nature do not have to be placed in trust accounts and are subject to the strict limitations of Disciplinary Rules 2-106(A) and (B) of the Code; and, pursuant to DR 2-110(A)(3), 2-110(B)(4) and other applicable legal authorities may be subject to accountability and refunding in certain instances.

In all instances where advanced or flat fees are deemed to be earned fees there must be a clear understanding with the client that the fees are earned fees and unrefundable.

This 11th day of December, 1992.

ETHICS COMMITTEE:

W. J. Michael Cody

Walker T. Tipton

Thomas H. Rainey

APPROVED AND ADOPTED BY THE BOARD

BOARD OF PROFESSIONAL RESPONSIBILITY
OF THE
SUPREME COURT OF TENNESSEE

FORMAL ETHICS OPINION 92-F-128(b)

Reconsideration of 92-F-128(a) relating to refundable
and nonrefundable fees has been requested.

A request for reconsideration of Formal Ethics Opinion 92-F-128(a) has been made stating that the opinion is not supported by the Code of Professional Responsibility; conflicts with the Code's prohibition against commingling; provides an opportunity to manipulate income; and, is unworkable and impractical. Adoption of the New York rule, that title and ownership of all fees paid to the lawyer belong to the lawyer, has been advocated.

A practice has arisen for lawyers to require clients to pay advanced fees, flat fees, retainer fees, prepaid fees, etc., before the lawyer commits to perform legal services. This is done not only to guarantee payment of some or all of the fees but to insure that the client believes in the cause and is willing to make a financial commitment to pursue the matter. This is a prevalent practice among all lawyers.

Disciplinary Rule 9-102 of the Code of Professional Responsibility, embodied in Tennessee Supreme Court Rule 8, provides that the identity of all funds and property of a client should be preserved. Emphasis of "all funds" is intended. DR 9-102 requires all funds belonging in part to a client and in part presently or potentially to the lawyer to be maintained in trust. The rule permits the portion belonging to the lawyer to be withdrawn "when due" unless the right of the lawyer to receive it is disputed by the client. The disputed portion shall not be withdrawn until the dispute is finally resolved. DR 9-102 also provides that no funds belonging to the lawyer shall be deposited in the lawyer's trust account "except" as permitted by the rule.

The dual requirements of the rule to preserve and maintain the identity of the funds of a client; and not to commingle the lawyer's funds are harmonious and not inconsistent. The rule expressly provides for the withdrawal of funds belonging to the lawyer. The ethics opinion likewise provides for the withdrawal of fees when they become earned. There is no inherent tension in the fiduciary duties required by DR 9-102.

The ethics opinion clearly provides that earned fees belong solely to the lawyer, and given a clear understanding with the client, non-refundable retainer fees are permitted and considered to be earned fees.

The ethics opinion follows the prevailing rule which has been the traditional standard in Tennessee and nationwide for many years. The New York rule, providing that title and ownership of all fees paid to the lawyer belongs to the lawyer, is under attack. The New York Supreme Court, Appellate Division, Second Department in the case of *In re Cooperman*, N.Y.Sup. Ct., App.Div. 2d Dept., No. 90-00429, 1/25/93, recently ruled that lawyers cannot charge nonrefundable fees, stating that such a practice violates the ethical duty to refund the unearned portion of a fee, impinges on the client's absolute right to terminate the client-attorney relationship, and leads to attempts to collect excessive fees when the lawyer is discharged. The court also ruled that non-refundable fees are imbued with an absoluteness that conflicts with DR 2110(A)(3).

Ethics Opinion 92-F-128(a) permits advanced earned fees in the nature of a non-refundable retainer fee in certain instances; to compensate the lawyer for being available to represent the client; to compensate for committing time for representation precluding acceptance of other employment; and, to compensate for being conflicted out of accepting adverse employment. The ethics opinion permits earned advanced or flat fees in criminal, domestic or juvenile matters, and routine legal services. All instances involving prepaid fees are subject to a clear understanding with the client, preferably in writing, that the fees are earned and non-refundable.

There are presently no compelling reasons why the traditional rule embodied in Formal Ethics Opinion 92-F-128(a) should be abandoned in favor of the old New York rule, providing that all advanced fees belong to the lawyer, now under attack; or, the potentially revised New York rule prohibiting non-refundable retainers.

This 10th day of September, 1993.

ETHICS COMMITTEE:

Thomas-H. Rainey

Herman Morris, Jr.

Walker T. Tipton

APPROVED AND ADOPTED BY THE BOARD

BOARD OF PROFESSIONAL RESPONSIBILITY
OF THE
SUPREME COURT OF TENNESSEE

FORMAL ETHICS OPINION NO. 2010-F-154

Inquiry is made regarding the propriety of requesting or requiring plaintiff's attorney to enter into agreements or releases which require the attorney to insure payment of medical bills or liens or to indemnify and hold harmless any party being released.

Inquiry is made as follows:

May a plaintiff's attorney be required to execute a Release which requires that attorney to ensure that medical expenses and liens applicable to his or her client are paid from the settlement proceeds, when the representation is made during settlement negotiations that an agreement with the medical lien holder has been reached and payment will be made from the settlement proceeds?

May an attorney representing a plaintiff in personal injury litigation be required to indemnify and hold harmless any party being released as a result of the settlement negotiations from any medical expenses and/or liens which that attorney has represented will be satisfied and/or settled from applicable settlement proceeds, or which the law requires to be satisfied from any settlement?

It must first be determined to what extent a plaintiff's attorney is obligated to withhold settlement proceeds from the client to pay outstanding medical bills or liens.

Rules of Professional Conduct (RPC) 1.15(c), as amended July 8, 2009, provides:

(c) Upon receiving funds or other property in which a client or third person has an interest, a lawyer shall promptly notify the client or third person. Except as stated in this Rule or otherwise permitted by law or by agreement with the client, a lawyer shall promptly deliver to the client or third person any funds or other property that the client or third person is entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding such funds or other property. If a dispute arises between the client and a third person with respect to their respective interests in the funds or property held by the lawyer, the portion in dispute shall be kept separate and safeguarded by the lawyer until the dispute is resolved. (underlining added)

Comment [10] to RPC 1.15 provides:

Third parties, such as a client's creditors, may have just claims against funds or other property in a lawyer's custody. A lawyer may have a duty under applicable law to protect such third-party claims against wrongful interference by the client and accordingly may refuse to surrender the property to the client. However, a lawyer should not unilaterally assume to arbitrate a dispute between the client and the third party. If not inconsistent with the interests of the client, the lawyer may file an interpleader action concerning funds in dispute between the client and a third party. (underlining added)

Tennessee Formal Ethics Opinion 87-F-109, adopted September 16, 1987, considered this issue prior to the adoption of the Rules of Professional Conduct and provided as follows:

This ethics opinion holds that a lawyer who has notice that a creditor of the client has a lien or assignment to the funds held on behalf of the client is ethically obligated to segregate and retain the disputed funds until the dispute is resolved. Payment of the disputed amount into court for a resolution of the matter is permissible after the parties have had a reasonable opportunity to resolve the dispute.

If there is no legitimate dispute about who is entitled to all or part of the funds in the attorney's possession, the attorney must disburse the undisputed portion of the funds to the client or the third person as is appropriate. D.C. Ethics Op. 293 (1999); N.Y. State Op. 717 (1999). However, if the attorney is aware that a third person has a "just claim", the attorney may not ignore the third person's interest, but is ethically obligated to disregard his client's demands for the funds in the attorney's possession and to hold the funds until the dispute is resolved. *Id.*

As provided in RPC 1.15, cmt. [10], the third person must have a "just claim" as to which "applicable law" imposes "a duty" on the attorney before RPC 1.15 imposes an obligation on the attorney to distribute the settlement funds to the third party or to safeguard the funds until a dispute is resolved. The phrases "just claims" and "duty under applicable law" have been construed to mean that the only type of third party "interest" which the attorney should preserve for a third person for whom the attorney has not agreed to serve as escrow agent is a matured lien on the disputed funds. Pa. Ethics Op. 2003-4 (2003); D.C. Ethics Op. 293 (1999). The term "interest" has been deemed to extend to a valid assignment by the client and to rights created by order of a court. Absent such an interest, the attorney has no ethical duty to withhold the funds from the client. *Id.* Unless the lawyer knows that the third person has a just claim, the attorney should deliver the funds to the client. *Id.*

A review of ethics opinions regarding this issue make it clear that the mere assertion by a third person or entity that they are entitled to funds in the possession of the attorney does not obligate the attorney to comply with Rule 1.15 to remit the funds to the third person or to safeguard

the funds until the dispute is resolved.¹ A “just claim” which Rule 1.15 obligates the attorney to honor is one which relates to the particular funds in the lawyer’s possession. Ariz. Ethics Op. 98-06 (1998); D.C. Ethics Op. 293 (1999). Mere debts of the client that come to the attention of the attorney are not “interests” protected by Rule 1.15. A lawyer is not required to pay the general unsecured creditors of the client, including judgment creditors, who have not attached or garnished the funds in the lawyer’s possession. Ariz. Ethics Op. 98-06 (1998); D.C. Ethics Op. 293 (1999); Conn. Informal Op. 95-20 (1995) (mere assertion of claim insufficient to create duty). D.C. Ethics Op. 293 (1999) held that the following were “just claims”:

¹Conn. Informal Ethics Op. 01-08 (2001), a lawyer has a duty to deliver the client’s property to the client upon the client’s demand, despite a third party’s claim to the property, unless the lawyers knows of: (1) a valid judgment relating to disposition of the property; (2) a valid and perfected statutory contractual or judgment lien against the property; (3) a letter of protection or similar obligation specifically entered into to aid the lawyer in obtaining the property; or (4) a written assignment, signed by the client, counsel or other individual with such authority conveying interest in the property to another person or entity. Md. Ethics Op. 97-20 (1997) (lawyer may disburse entire settlement to client where hospital failed to timely submit bills to insurer and thus had no legally valid claim); Ariz. Ethics Op. 88-6 (1988) (third-party claim that is not perfected lien or assignment does not affect client’s right); Colo. Ethics Op. 94 (1993) (lawyer must distribute promptly to client if third person’s claim does not arise out of statutory lien, contract, or court order); Conn. Informal Ethics Op. 95-20 (1995) (lawyer has no duty to act on mere assertions of third-party interests or to investigate whether third persons have interests in the client property); Phila. Ethics Op. 86-134 (1986) (lawyer must disburse to client without retaining anything for physicians who are owed payment, provided that there is no agreement between doctors and client regarding proceeds from settlement); Md. Ethics Op. 94-19 (1993) (lawyer must disregard client instruction not to pay creditor where client had a valid agreement with creditor); Ohio Supreme Court Ethics Op. 95-12 (1995) (lawyer must disregard client’s instruction not to pay physician when client entered earlier agreement to pay medical expenses from such proceeds); S.C. Ethics Op. 94-20 (1994) (if lawyer knows client has executed valid doctor’s lien he may not comply with client’s instruction to disregard it); Ariz. Ethics Op. 98-06 (1998) (“actual knowledge” of assignment, medical lien, statutory lien, and letter of protection can trigger lawyer’s duty to protect nonclient’s interests); Alaska Ethics Op. 92-3 (1992) (lawyer may not follow client’s instruction to disregard facially valid assignment or statutory lien in favor of client’s creditor; lawyer should advise client that he will withhold disputed funds until dispute is resolved); Cal. Formal Ethics Op. 1988-101 (lawyer whose client agreed to pay recovery proceeds to health care provider may not disburse all money to client upon client’s request); Md. Ethics Op. 96-16 (1996) (lawyer whose client instructs him not to pay creditor-despite client’s subrogation agreement with creditor-must hold funds until dispute is resolved); Mich. Informal Ethics Op. RI-61 (1990) (lawyer may not disburse to client if aware of outstanding lien; instead must initiate court proceedings to resolve which portion of funds belong to lien holder and client); R.I. Ethics Op. 95-60 (1996) (lawyer cannot obey client’s instruction to refuse reimbursement to health insurer where insurer has legally enforceable interest in the funds); R.I. Ethics Op. 95-31 (1995) (lawyer, whose client agreed in writing to pay wife one-half of personal injury proceeds, cannot ignore contract and must keep disputed portion of award separate until resolution); S.C. Ethics Op. 93-14 (1993) (attorney who agreed to honor all written statements signed by client regarding lien for medical care provider may not ignore client’s instruction to do otherwise); Iowa Ethics Op. 89-32 (1989) (lawyer may sign agreement to withhold amount client owes his doctor from settlement and submit the money directly to the doctor); Wash. Ethics Op. 185 (if lawyer guaranteed payment to creditor, he must-after advising client of effect of such guarantee-pay creditor unless there is good faith dispute as to amount of debt); N.C. Ethics Op. 2001-11 (2002) (lawyer authorized by client to pay medical provider upon settlement may, when client changes mind, hold disputed funds in trust until impasse resolved by agreement or court order; even though no lien, lawyer should honor representation made to third party); Pa. Ethics Op. 2004-118 (2004) (lawyer who settled client’s suit and escrowed money to satisfy workers’ compensation lien must continue to hold funds notwithstanding client’s demand to give client the money); S.C. Ethics Op. 05-08 (2005) (even in absence of letter of protection, lawyer who knows that insurer has subrogation claim against settlement proceeds may not pay all proceeds to client but must retain sufficient funds to pay subrogation claim); Mo. Ethics Op. 970215 (1997) (lawyer who advised client to agree with creditor to pay outstanding debt out of proceeds of settlement of unrelated matter may not thereafter disburse settlement funds to client without consent of creditor, even if client asks lawyer not to pay creditor; lawyer may hold funds in lawyer’s trust account for reasonable period of time to allow for resolution and should thereafter file interpleader action if necessary).

- (1) an attachment or garnishment arising out of a money judgment against the client;
- (2) a statutory lien that applies to the proceeds of the suit being handled by the lawyer;
- (3) a court order relating to the specific funds in the lawyer's possession;
- (4) a contractual agreement, commonly known as an authorization and assignment, made by the client and joined in or ratified by the lawyer

The determination of whether, and to what extent, the third person's claim rises to the level of a colorable interest worthy of protection under Rule 1.15 is a matter of substantive law. Pa. Ethics Op. 2003-4 (2003). In performing that analysis, one should consider whether the client signed a third party reimbursement form, participation agreement or other document addressing the right of subrogation; whether the right to subrogation is statutory and/or subject to federal pre-emption; whether the right of subrogation is secured or unsecured; and whether the attorney or client has represented to the third party that it would be paid. *Id.*

It is concluded that RPC 1.15(c) does not obligate an attorney to pay the settlement funds to the third person or to safeguard the funds until the dispute is resolved unless one of the following exist: (1) an attachment or garnishment arising out of a valid judgment relating to disposition of the funds; (2) a valid and perfected statutory, contractual or judgment lien against the property; (3) a letter of protection or similar obligation specifically entered into to aid in obtaining the funds; (4) a written assignment or authorization signed by the client, counsel or other individual with authority conveying interest in the funds to the third person or entity; or (5) a court order relating to the funds in the attorney's possession. See *ftnt.* 1 at page 3.

Arizona Ethics Op. 98-06 (1998) analyzed this issue with respect to twelve different factual scenarios. The opinion held that in situations: (1) in which the attorney had notice of the medical provider's lien signed by the client, but not recorded, (2) in which the medical provider's lien was signed by the client and by the attorney, (3) in which the attorney orally agreed to reimburse the medical provider from settlement proceeds, (4) in which the attorney or client had signed a letter of protection in favor of the medical provider, (5) in which the client had signed an assignment in favor of the medical provider, or (6) in which both the client and the attorney signed an assignment in favor of the medical provider, the attorney was required to comply with Rule 1.15 to protect the interest of the medical provider. In situation (7) in which a statutory lien was facially incomplete or untimely, but had been properly recorded, the attorney was required by Rule 1.15 to protect the provider's interest by holding the funds in dispute, but could contest the lien by interpleader or other proper means. In situations: (8) in which the attorney was aware of medical services provided by the medical provider because medical bills had been provided to the attorney by the client, but for which the provider had made no demand upon the attorney, (9) in which the medical provider had simply sent copies of the client's medical bills to the attorney, (10) in which the provider simply sent a letter to the attorney demanding payment for medical bills, (11) in which the attorney simply knew that the medical provider had treated the plaintiff, but the medical provider had no lien nor assignment and had taken no other demand action with regard to the bills, or (12) in which the medical provider's lien was not signed by the client nor attorney and was not recorded, the attorney was not required to notify nor disburse funds to the medical provider in compliance with

Rule 1.15. The determinations made in the Arizona Opinion are consistent with and adopted in this opinion.

An attorney should not disburse the funds in his possession to a third person if the client contests the issue.² If the attorney has a “good faith doubt” as to who is entitled to receive the disputed funds, the attorney must investigate, notify the third person, hold only the disputed funds and resolve the dispute by negotiation, arbitration or interpleader if necessary.³

If there is a legitimate dispute as to ownership of the funds, an attorney “should not unilaterally assume to arbitrate a dispute between the client and a third party.” RPC 1.15, cmt. [10]. The comment provides that filing an interpleader action is one alternative to resolve the dispute. The Rules of Professional Conduct do not otherwise prescribe the method of resolving the dispute nor impose a duty upon the attorney holding such funds to initiate an action in any particular forum or within a particular time frame. Such issues are controlled by the substantive law governing fiduciaries. Pa. Ethics Op. 2003-4 (2003).

If the attorney ignores a duty owed to a third person and pays the disputed amount directly to the client, the lawyer may be held liable to the third person. Such liability is a matter of substantive law beyond the scope of this opinion. *Aetna Cas. & Sur. Co. V. Gilreath*, 625 S.W.2d 269, 274 (Tenn. 1981), citing *Motors Ins. Corp. v. Blakemore*, 584 S.W.2d 204, 207 (Tenn. App. 1978), held:

... a lawyer will be held civilly liable to a non-client where he knowingly participates in the extinguishment of a subrogation interest of a non-client third party and delivers to his client funds that he knows belong to the third party and knows or should know, that he has thereby placed the funds beyond the reach of the third party ...

See also, *Hankins v. Seaton*, 1998 Tenn. App. LEXIS 419 (Tenn. Ct. App. June 25, 1998) (attorney liable for failure to honor a signed subrogation agreement); *Greenwood Mills, Inc., v. Burris*, et.

²Conn. Informal Ethics Op. 95-20 (1995) (lawyer cannot pay money to third person over client’s objection); Pa. Ethics Op. 92-89 (1992) (lawyer, whose client was ordered to pay arrearage in child support, cannot release escrow proceeds from real estate sale without client consent); R.I. Ethics Op. 2007-02 (2007) (where the client insists that the settlement proceeds be disbursed to the client, and where the inquiring attorney has received no notice of a claim from the health insurer, the inquiring attorney must disburse the settlement funds to the client).

³Ariz. Ethics Op. 88-6 (1988) (lawyer may disburse money if he has concluded that one party is entitled to it under applicable law; but if good faith doubt, he should deposit into trust account pending resolution of matter and initiate an interpleader action or other proceeding to resolve the dispute); Ariz. Ethics Op. 98-06 (1998) (“actual knowledge” of assignment, medical lien, statutory lien, and letter of protection can trigger lawyer’s duty to protect nonclient’s interests; but good faith doubt requires lawyer to place disputed portion of funds in trust pending resolution of conflicting claims); Ohio Supreme Court Ethics Op. 95-12 (1995) (lawyer should hold disputed portion of funds until resolution by arbitration or court action); Utah Ethics Op. 00-04 (2000) (if client in good faith disputes creditor’s interest and instructs lawyer not to disburse property, counsel must protect property until dispute is resolved); Wash. Ethics Op. 185 (if lawyer guaranteed payment to creditor, he must-after advising client of effect of such guarantee-pay creditor unless there is good faith dispute as to amount of debt).

al., 130 F.Supp.2d 949 (D.C. Tenn. 2001) (attorney liable for failure to pay ERISA subrogation interest).

Tennessee Formal Ethics Opinion (TFEO) 97-F-141, issued February 4, 1998, addressed clauses proposed by defense attorneys for inclusion in releases to settle personal injury cases. The opinion held, in part:

The attorney's signature on a release should vouch only for the fact that the client releases the defendant. A requirement that a plaintiff's attorney become a party to a release might create conflict of interest between plaintiff's attorney and the plaintiff in violation of DR 5-101(A). Therefore, these clauses are prohibited except in cases where the plaintiff's attorney releases a claim for attorney fees.

RPC 1.7(b), Conflict of Interest: General Rule, provides in part:

(b) A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests, unless:

- (1) the lawyer reasonably believes the representation will not be adversely affected; and
- (2) the client consents in writing after consultation.

* * *

Comment [8] to RPC 1.7 provides in part:

The lawyer's own interests should not be permitted to have an adverse effect on the representation of a client . . . If the probity of a lawyer's own conduct in a transaction is in serious question, it may be difficult or impossible for the lawyer to give a client detached advice. A lawyer may not allow related business interests to affect representation, for example, by referring clients to an enterprise in which the lawyer has an undisclosed interest.

Arizona Opinion 03-05 (2003) considered the same question posed in the second paragraph of the inquiry herein. The Arizona opinion held, in part:

The mere request that an attorney agree to indemnify Releasees against lien claims creates a potential conflict of interest between the claimant and the claimant's attorney. The attorney's refusal, for ethical reasons, to accede to such a demand as a condition of settlement could prevent the client from effectuating a settlement that the client otherwise desires.

The insistence upon an attorney's agreement to indemnify as a condition of settlement could, for example, cause the lawyer to recommend that the client reject an offer that would be in the client's best interest because it would potentially expose the lawyer to the payment of hundreds of thousands of dollars in lien expenses, or litigation over such lien expenses.

The attorney's acceptance of such a condition would also create a conflict of interest with an existing client under ER 1.7 because the client's failure or refusal to repay a lien could make the client's lawyer its guarantor.

That might materially limit the representation by virtue of the lawyer's own interest in having the client (rather than the lawyer) pay the liens in full. Even if the lawyer were willing to accept that potential financial burden, and even if the lawyer were ethically permitted to provide such financial assistance, such an agreement might compromise the lawyer's exercise of independent professional judgment and rendering of candid advice in violation of ER 2.1.

While ER 1.2 requires an attorney to abide by a client's decision whether to accept an offer of settlement, a settlement agreement that requires the attorney to indemnify, or hold the Releasees harmless, violates ER 1.8.

Since, under ER 1.8, an attorney cannot ethically provide financial assistance to a client by paying, or advancing, the client's medical expenses before or during litigation, an attorney cannot ethically agree, voluntarily or at the client's or Releasees' insistence, to guarantee, or accept ultimate liability for, the payment of those expenses.

The ethics rules relied upon in the Arizona Opinion are consistent with Tennessee Rules of Professional Conduct 1.7(b), 2.1, 1.2, and 1.8(e) and that opinion's conclusions are adopted herein.⁴ It is apparent that requiring a plaintiff's attorney to enter into agreements posed in the inquiry, particularly requiring that the attorney indemnify and/or hold harmless any party being released or subrogation interest holder from medical expenses or liens, creates a conflict between the interests of the plaintiff's attorney and those of their client. Consistent with TFEQ 97-F-141, such agreements and/or clauses are prohibited. As discussed herein, the actions which are the subject of the first paragraph of the inquiry are obligations imposed upon the plaintiff's attorney by RPC 1.15(c). The attorney is obligated to safeguard the funds in his possession until any dispute between the client and the third person regarding the funds is resolved. It is apparent that whether the funds in the attorney's possession rightfully belong to the client or to the third person or entity may well not be determined at the time that the release resolving the lawsuit is executed. The attorney cannot be required to breach the ethical obligations imposed upon the attorney by RPC

⁴See also: Mo. Formal Op. 125 (2008) (it is a violation for an attorney to propose a settlement that includes a provision that would involve a violation of any of the Rules of Professional Conduct by another attorney); Ill. Adv. Op. 06-10-(2006); Kan. Op. 01-5 (2001).

1.15(c) by signing an agreement regarding disposition of the funds prior to the resolution of the dispute. If the attorney makes misrepresentations in settlement negotiations regarding payment of medical bills or liens, as posed in the inquiries, the attorney's conduct will be subject to Rules of Professional Conduct, including 4.1(a) and 8.4(c), and/or to liability pursuant substantive law beyond the scope of this opinion.

This 12th day of March, 2010.

ETHICS COMMITTEE:

Thomas S. Scott, Jr.

Virginia Anne Sharber

William C. Bovender

APPROVED AND ADOPTED BY THE BOARD