

TAON: Heightened Lawyer Accountability for Trust Accounts

Part 1: TAON—An Oversight Enhancement By Rhonda Spencer Pozehl

By order of the Michigan Supreme Court, Michigan has joined 41 other jurisdictions in adopting a rule requiring Trust Account Overdraft Notification (TAON). Beginning this fall, lawyers must place their trust accounts only at Michigan financial institutions that have signed an agreement indicating they will notify the grievance administrator of any transaction that either results in an overdraft of the lawyer's trust account or *would have* resulted in an overdraft of the account had the transaction been completed. The rule applies only to accounts in which the lawyer is holding other people's money and does not apply to a lawyer's law office business account.

The primary intent of the TAON rule is to serve as an early warning to the lawyer and the Attorney Grievance Commission that the lawyer is engaging in conduct that may result in injury to clients or third persons to whom funds are owed. The hope is that this notification will allow intervention before major losses occur and significant numbers of clients are harmed. The rule will also enable the grievance administrator's staff and the State Bar of Michigan to counsel lawyers regarding corrective action before the lawyers' misconduct becomes so egregious as to require serious sanction. With early warning, lawyers can institute changes to office protocols to avoid future overdrafts. An effective overdraft notification program is expected to conserve substantial resources for both clients and the State Bar of Michigan's Client Protection Fund.¹

Pursuant to Michigan Rule of Professional Conduct (MRPC) 1.15A, titled "Trust Account Overdraft Notification," also referred to as

the TAON rule, which takes effect September 15, 2010, lawyers can maintain trust accounts only at financial institutions approved by the State Bar of Michigan. Approval by the State Bar is conditioned on the financial institution's written agreement to notify the grievance administrator within five banking days of an overdraft of a lawyer trust account. Many Michigan financial institutions are already accustomed to such requirements based on their participation in TAON in other states and because they already notify customers when an overdraft occurs.

Beginning September 15, TAON-participating financial institutions must provide overdraft reports to the grievance administrator within five banking days of such transactions. The notice must contain the identity of the financial institution; the identity of the account holder(s); the account number; information identifying the transaction item; the amount and date of the overdraft; and either the amount of the returned instrument or other dishonored debit and the date returned or dishonored, or the date of presentation and the date paid.

While financial institutions must obtain approval, the onus is on the lawyer to maintain all Interest on Lawyers Trust Accounts (IOLTA) and non-IOLTA trust accounts at financial institutions that have agreed to provide the overdraft reports to the grievance administrator in accordance with the TAON rule. Michigan lawyers may view the list of approved financial institutions on the State

Bar of Michigan's website at http://www.michbar.org/opinions/TAON_list.pdf.

After confirming that their financial institution is on the State Bar's list of approved financial institutions, lawyers must contact their financial institution to change the name on any non-IOLTA trust accounts to include the term "trust" or "escrow" if not already included in the account name. To assist in notifying the financial institution to make the necessary changes, lawyers may download a form (Non-IOLTA Lawyer Trust Account Notice to Financial Institution) from the State Bar's website and submit the completed form to their approved financial institutions for each non-IOLTA trust account. Lawyers must also submit a copy of the form to the State Bar of Michigan. No further action is required by lawyers for their pre-existing IOLTA accounts; these accounts have already been identified as lawyer trust accounts by financial institutions when opened by lawyers.

Upon receipt of an overdraft notification, the grievance administrator's staff will conduct a preliminary review to determine whether the notification was a result of bank error. If it is readily discerned that the notification was a result of bank error, no further action will be taken by the administrator. If preliminary review suggests that the notification was *not* the result of bank error, a grievance administrator's request for investigation may be issued to the lawyer(s) in whose name the account is held.² Pursuant

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TAON Fast Facts for Lawyers:

- "TAON" stands for Trust Account Overdraft Notification, the short name for MRPC 1.15A, recently adopted by the Michigan Supreme Court and effective September 15, 2010.
- TAON requires *lawyers* holding funds in trust, including funds held in any fiduciary capacity in connection with a representation, whether as trustee, agent, guardian, executor, or otherwise, to *deposit* those funds only at *State Bar-approved financial institutions*.
- Under TAON, *financial institutions* agree to *notify the grievance administrator within five banking days* of the presentment of any transaction that either results in an overdraft of the lawyer's trust account or would have resulted in an overdraft of the account.
- TAON requires the *lawyer* who receives notification from the grievance administrator to *respond to a grievance administrator's request for investigation within 21 days*, providing a full and fair explanation of the cause of the overdraft and how it was corrected.
- While there will be no automatic disciplinary consequence associated with a lawyer's receipt of a TAON notice, a lawyer/account holder who is the subject of such notice may be required to participate in remedial education regarding proper handling of third-party funds being held in trust.

to MRPC 1.15A(f), every lawyer who receives an overdraft notification shall, upon receipt of a request for investigation from the grievance administrator, provide to the grievance administrator within 21 days after issuance of such request a full and fair explanation, in writing, of the cause of the overdraft and how it was corrected.

Pursuant to MCR 9.109(B)(5), the lawyer(s) in whose name(s) the account is held will be requested to provide a signed written explanation for the overdraft or presentment of check(s) or other debit(s) against nonsufficient funds. The lawyer(s) will be asked to identify the payee(s) and purpose of the paid/returned transaction(s); the source and purpose of the related deposit(s), if any; and what steps, if any, the lawyer took to rectify the situation, including paying any associated bank fees. Copies (front and back) of the paid or returned item(s) will be requested as well as copies of the relevant account statements for the preceding three months, including the statement(s) that reflect the overdraft(s). Copies of any and all records that correspond with the lawyer's last three monthly account statements, including but not limited to records showing the source and purpose of deposits and information as to the payee and purpose

of checks issued from the account, general ledgers, client ledgers, and the lawyer's trust account reconciliations will be sought.

After the lawyer is afforded an opportunity to provide an initial response to the

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grievance administrator's request for investigation along with the requested information and records, the grievance administrator may close the matter or request more detailed information and additional records if needed to determine the cause of the overdraft notice. An overdraft notification will not automatically result in formal disciplinary charges. In fact, based on data from approximately 40 other jurisdictions that already have such a rule in place, it is anticipated that the vast majority of the files

opened based on an overdraft notification will be closed without the Attorney Grievance Commission's pursuit of formal disciplinary action against the account holder because a preliminary investigation has determined that there is an explanation that adequately explains the cause of the overdraft, such as a clerical error that is not the fault of the attorney/account holder. As part of the disposition of the file, however, attorneys may be required to attend the State Bar of Michigan's Tips and Tools for a Successful Practice Workshop, referred to the State Bar of Michigan's Practice Management Resource Center for instruction, or required to attend another such educational pursuit.

For more information regarding the TAON rule and program, please visit the State Bar of Michigan's website at <http://www.michbar.org/opinions/TAON.cfm>. ■



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FOOTNOTES

1. Client Protection Fund Rule 1A ("The purpose of the Michigan Client Protection Fund [Fund] is to promote public confidence in the administration of justice and integrity of the legal profession by reimbursing losses caused by the dishonest conduct of lawyers admitted and licensed to practice law in Michigan. Reimbursable losses must have occurred in the course of the lawyer-client or other fiduciary relationship between the lawyer and claimant, and must have a significant contact with Michigan."). For more information regarding the fund, please see <http://www.michbar.org/client/protectionfund.cfm>. All websites cited in this article were accessed July 11, 2010.
2. A request for investigation is an informal complaint form used by the Attorney Grievance Commission to initiate an investigation of lawyer conduct. A completed request for investigation form is served on the lawyer to provide notice that an ethical inquiry has been made and to give the lawyer an opportunity to respond to the inquiry. Pursuant to MCR 9.109(B)(5), the grievance administrator may serve a request for investigation in his or her own name.

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Part 2:

TAON—An Enhanced Caretaker Duty

By Danon D. Goodrum-Garland

"Zero tolerance," generally known as the policy or practice of not tolerating undesirable behavior, has been embraced in recent years by the public and private sectors to emphasize and enforce legal and regulatory prevention efforts. Although the zero-tolerance terminology has not typically been used in connection with the regulation of lawyer conduct in Michigan, in reality the concept has been in place for many years regarding the duties of Michigan lawyers to safeguard client property in their possession. Since its adoption by the Michigan Supreme Court, Michigan Rule of Professional Conduct (MRPC) 1.15, aptly entitled "Safekeeping Property," has conceptually embraced zero tolerance regarding the caretaker obligation of lawyers, which consists of five essential elements: a duty to notify, safeguard, segregate, deliver, and account for funds belonging to the client or third party.¹ A lawyer's reported violation² of his or her caretaker duty is ethical misconduct that may warrant disciplinary action by the Attorney Grievance Commission.

With the adoption of MRPC 1.15A, commonly known as the TAON rule, the Michigan Supreme Court has provided an additional mechanism by which our lawyer disciplinary system may determine whether Michigan lawyers are adhering to their caretaker duty in managing client and third-party funds entrusted to them. Thus, Michigan lawyers should be further incentivized to ensure full compliance with their caretaker duty to avoid disciplinary consequences associated with fiduciary breach of the zero-tolerance principles advanced by MRPC 1.15A and MRPC 1.15.

Comprehensive and accurate recordkeeping by lawyers regarding their trust accounts is essential to fully comply with the caretaker duty required by MRPC 1.15. While MRPC 1.15(b)(2)³ requires lawyers to maintain "complete records" regarding their trust accounts for a minimum of five years after the representation has terminated, it lacks specificity regarding what constitutes complete records and offers no guidance to law-

yers regarding the necessary procedures they should implement for compliance purposes. Lawyers failing to incorporate effective recordkeeping measures are likely to fall prey to the zero-tolerance enhancement of the TAON rule.

The American Bar Association (ABA) Model Rule on Financial Recordkeeping⁴ provides practical guidance to lawyers regarding how to comply with their MRPC 1.15 caretaker obligation. It gives a two-part approach. First, a detailed list of the types of records lawyers should generate and maintain to meet the complete records requirement of MRPC 1.15 is provided. The categorized list of records is followed by practical procedures and policies lawyers should implement regarding their trust accounts to ensure adherence to their caretaker duty.

Lawyers are encouraged to vigilantly maintain nine categories of records as identified in paragraph A of the ABA Model Rule on Financial Recordkeeping:

A. A lawyer who practices in this jurisdiction shall maintain current financial records as provided in the rule, and shall retain the following records for a period of [five years] after termination of the representation.

(1) receipt and disbursement journals containing a record of deposits to and withdrawals from bank accounts which concern or affect the lawyer's practice of law, specifically identifying the date, source, and description of each item deposited, as well as the date, payee and purpose of each disbursement;

(2) ledger records for all trust accounts required by [Rule 1.15 of the Model Rules of Professional Conduct], showing, for each separate trust client or beneficiary, the source of all funds deposited, the names of all persons for

whom the funds are or were held, the amount of such funds, the descriptions and amounts of charges or withdrawals, and the names of all persons to whom such funds were disbursed;

(3) copies of retainer and compensation agreements with clients [as required by Rule 1.5 of the Model Rules of Professional Conduct];

(4) copies of accountings to clients or third persons showing the disbursement of funds to them or on their behalf;

(5) copies of bills for legal fees and expenses rendered to clients;

(6) copies of records showing disbursements on behalf of clients;

(7) checkbook registers or check stubs, bank statements, records of deposit, and prenumbered canceled checks or their equivalent;

(8) copies of [monthly] trial balances and [quarterly] reconciliations of the lawyer's trust accounts; and

(9) copies of those portions of clients' files that are reasonably necessary for a complete understanding of the financial transactions pertaining to them.

Lawyers are unlikely to fully realize the intended safeguard of the recordkeeping measures if the records are not routinely prepared and the procedures routinely followed as set forth above. The comment to the ABA Model Rule provides additional explanation on the proper method to compute the "trial balance" described in paragraph A(8). The trial balance is defined as the total amount of the balance of each client ledger record (paragraph A(2)). The comment emphasizes that the value of the trial balance may be greatly diminished if the monthly comparison to the control balance (determined by adding the trust receipts to the

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TAON Fast Facts for Lawyers:

- TAON heightens the need for lawyers to be vigilant in performing their MRPC 1.15 caretaker obligation.
- Collectively, TAON and MRPC 1.15 advance a zero-tolerance approach to ensure ethical financial management by lawyers of their trust accounts.
- MRPC 1.15 requires lawyers to maintain "complete records" of their trust accounts for a minimum of five years after termination of the representation. Trust account records will be sought by the grievance administrator when investigating overdraft reports as a result of TAON to determine whether further investigation and disciplinary action are needed.
- MRPC 1.15 does not provide guidance to lawyers regarding what are deemed complete records or an effective financial management system to use in performing their caretaker duty.
- The ABA Model Rule on Financial Recordkeeping provides practical guidance regarding comprehensive and accurate recordkeeping that may be used by Michigan lawyers to achieve compliance with the zero-tolerance policy advanced by the TAON and safekeeping property rules.

previous month's balance and subtracting disbursements, then confirming that this figure matches the trial balance) is not routinely performed followed by the reconciliation process (adding the total amount of outstanding checks to the trial balance and subtracting any deposits that have not been credited by the bank by the end of the month, then comparing the balance to the bank statement). Although the ABA Model Rule requires only quarterly reconciliation, the comment suggests monthly reconciliation to reduce the difficulty of identifying accounting errors when reviewing three months of transactions as compared to one month of transactions.

Paragraphs B and C of the ABA Model Rule on Financial Recordkeeping set forth the recommended cautionary procedural measures that lawyers should implement to prevent both unintended and sometimes intentional mishandling of their trust accounts. They are, in pertinent part:

B. With respect to trust accounts required by [Rule 1.15 of the Model Rules of Professional Conduct]:

- (1) only a lawyer admitted to practice law in this jurisdiction shall be an authorized signatory on the account;
- (2) receipts shall be deposited intact and records of deposit should be sufficiently detailed to identify each item; and

(3) withdrawals shall be made only by check payable to a named payee and not to cash, or by authorized bank transfer.

C. Records required by this rule may be maintained by electronic, photographic, computer or other media provided that they otherwise comply with this rule and provided further that printed copies can be produced. These records shall be located at the lawyer's principal office in the jurisdiction or in a readily accessible location.

These recommended policies and procedures emphasize the need for lawyers to be "hands-on" in their involvement in handling trust account transactions and the associated recordkeeping to ensure that they achieve the zero-tolerance goals advanced by both the safekeeping property and TAON rules.

Currently, there is no ethical rule requiring Michigan lawyers to follow the provisions of the ABA Model Rule on Financial Recordkeeping. Michigan lawyers who already have an effective financial management system in place that ensures compliance with their caretaker duty do not need to make adjustments in management of their trust accounts. Michigan lawyers who may not have previously been attentive to their caretaker duty should take immediate pause to put in place an effective financial management system to avoid the potential disci-

plinary consequences of violating the zero-tolerance policies advanced by the TAON and the safekeeping property rules.

For more information regarding the TAON rule and program and the caretaker duty of lawyers, please visit the State Bar of Michigan's website at <http://www.michbar.org/opinions/TAON.cfm> and <http://www.michbar.org/pmrc/articles/0000145.pdf>. ■



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FOOTNOTES

1. MRPC 1.15(b), (c), (d), (h), and (g). For additional information regarding establishing trust accounts and the caretaker obligation of lawyers regarding trust accounts, see *A Discussion of Trust Accounts for Michigan Lawyers* (2009), available at <<http://www.michbar.org/pmrc/articles/0000145.pdf>>.
2. Before the adoption of the TAON rule, information about a lawyer's failure to adhere to his or her safeguarding and accounting duties would generally become known to the grievance administrator as a result of a grievance complaint or criminal prosecution for theft/misappropriation of client or third-party funds. As a result of the TAON rule, an overdraft report will be a triggering event for an investigation by the grievance administrator and will hopefully help prevent irreparable harm to clients and third parties resulting from financial mismanagement or improper use of lawyer trust accounts.
3. MRPC 1.15(b)(2) ["A lawyer shall . . . preserve complete records of such account funds and other property for a period of five years after termination of the representation."].
4. The ABA Model Rule on Financial Recordkeeping, adopted in February of 1993, is intended to give lawyers guidance about the basic financial records that lawyers should maintain regarding their trust accounts. The full text of the rule is available at <<http://www.abanet.org/cpr/clientpro/fpreface.html>>; see also Implementation of ABA Model, available at <<http://www.abanet.org/cpr/clientpro/recordkeeping.pdf>>, for a survey of the approach taken by other jurisdictions in enumerating the required accounting controls to ensure lawyers comply with their safekeeping/caretaker duty.