

Common Trust Accounting Pitfalls and Avoiding Trust Account Overdraft Notifications

By Rhonda Spencer Pozehl and Dina P. Dajani

In September 2010, Michigan joined 41 other jurisdictions in adopting MRPC 1.15A, the Trust Account Overdraft Notification (TAON) rule. This rule requires lawyers to hold all trust funds in accordance with MRPC 1.15 and, specifically, to hold only client or third-person funds in a trust account. Funds held in trust include those held in *any* fiduciary capacity in connection with a representation, including as an attorney, trustee, agent, guardian, executor, or otherwise.

The TAON rule requires lawyers to maintain their trust accounts only at financial institutions that are registered with the Securities and Exchange Commission and approved by the State Bar of Michigan. The approved list of financial institutions is available on the State Bar's website at <http://www.michbar.org/opinions/TAON.cfm#list>.

Approved financial institutions are required to submit reports to the grievance administrator at the Attorney Grievance Commission when any properly payable instrument is presented against a trust account containing insufficient funds *or* when any other debit to the trust account creates a negative balance in the account—even if the instrument is honored by the financial institution—so the item is not rejected or returned unpaid to the payee. When an overdraft notification is received, it is reviewed to determine whether the matter warrants further action. On rare occasions, such as when the overdraft notification is clearly defective on its face or when the financial institution promptly states that the notification was issued in error, no further action is taken.

If the notification warrants further action, the lawyer will receive an inquiry letter (when the overdraft amount is less than \$5 or the account holder is a public

administrator) or a grievance administrator's request for investigation, which requires a written answer and the production of bank records for the subject trust account. Bank records typically requested include the bank account statements with corresponding canceled checks, duplicate deposit slips, and general and individual client ledgers for a three-month period. Once an inquiry letter or a request for investigation is issued, the lawyer must respond within 21 days from the date the letter is mailed unless an extension is granted.

The primary intent of the TAON rule is to provide an early warning to both the lawyer and the Attorney Grievance Commission that the lawyer is engaging in conduct that could result in injury to clients or third persons to whom funds are owed. As of December 2014, the Commission has received more than 2,000 overdraft notifications. During the more than four years since implementation of the TAON rule, some trends have emerged. Here are the top five reasons lawyers receive overdraft notifications and some pointers for avoiding them.

Bank error

Although it does happen, it is extremely rare for an overdraft to be caused solely by bank error. A bank error can result in an overdraft when, through no fault of the lawyer, an instrument is deposited to the wrong account. For instance, even though a deposit ticket identifies the correct account, a teller may key in the wrong number when processing the transaction. Often, a lawyer will obtain a letter from the bank documenting the bank's responsibility and asserting that the overdraft notification





was issued as a result of bank error, even when it is not truly the bank's fault. The bank's purported responsibility is not necessarily accepted, and further investigation regarding the cause of the overdraft will ensue.

Lack of proper endorsement

Lawyers should ensure that all items deposited to their trust accounts are fully endorsed to avoid having a deposited item returned for lack of proper endorsement, thus prompting an overdraft notification. Many overdraft notifications occur when—either as a result of oversight or an intentional attempt to cut corners—all necessary endorsements were not obtained on items deposited to a trust account. For example, in a divorce action, a lawyer might receive a check payable to the client and the client's former spouse. For purposes of convenience and in seeking to avoid a perceived delay in obtaining the opposing party's signature on the check, the lawyer may believe it appropriate to stamp the check "for deposit only" to relieve the lawyer of the task of obtaining all necessary endorsements. The lawyer's bank may accept the check for deposit, especially if the lawyer is

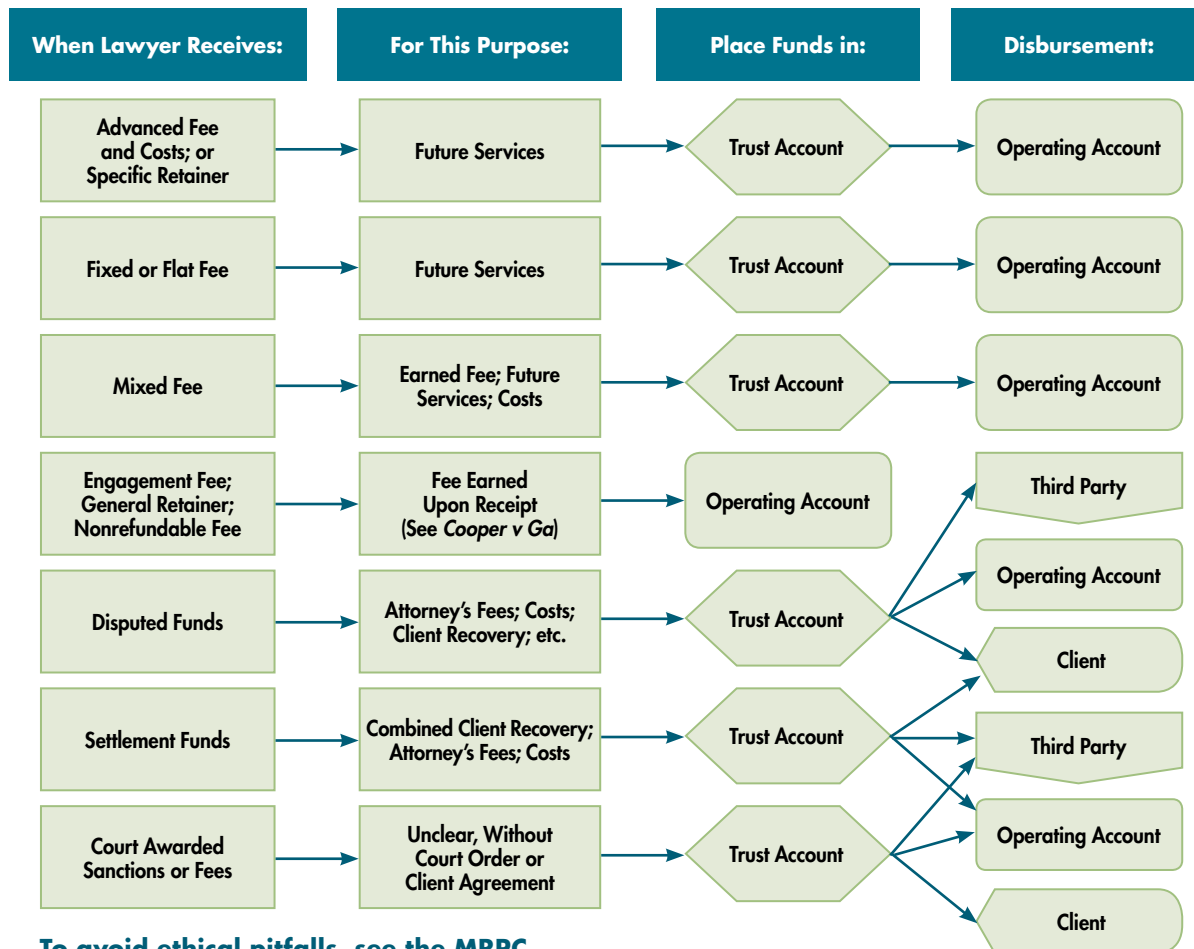
a longstanding customer. However, if the check is not fully endorsed, the check may later be returned for lack of proper endorsement, often by the payee bank. This can lead to a deficiency in the trust account, cause delay in disbursing funds to the client, and prompt an overdraft notification.

Premature disbursement of funds

It is important to ensure that settlement checks are properly deposited and cleared before funds are disbursed to the client or third person entitled to the funds. In some instances, checks are placed in a safe or drawer for safekeeping until the deposit can be made. Occasionally, overdrafts are caused when, during the press of business, the funds received are not timely deposited. Most overdraft notifications occur when lawyers disburse funds before the corresponding deposited funds have cleared the trust account. Lawyers should *never* disburse funds before verifying that the corresponding funds on which the trust account check is drawn have been deposited, have *cleared* the trust account, and are available for disbursement.

SBM MONEY MANAGEMENT MAP

Adapted by the State Bar of Michigan for educational purposes.



To avoid ethical pitfalls, see the MRPC.

Credit card payments

Credit card payments by clients for advance fees or costs present many potential ethical pitfalls. Although credit card payments may be convenient, lawyers are cautioned to ensure that client confidentiality is protected and credit card charges or chargebacks do not improperly affect the trust account. In this regard, lawyers who accept credit card payments for attorney fees and costs should fully review Ethics Opinion RI-344 issued by the State Bar.

Accounting and recordkeeping errors

Accounting and recordkeeping errors can lead to overdraft notifications. Good recordkeeping practices usually prevent most errors or allow detection before the errors

result in an overdraft notification. Additionally, reasonable measures should be in effect to assure that the conduct of nonlawyer assistants does not result in the lawyer's violation of the Michigan Rules of Professional Conduct.

When an overdraft notification is the result of one of the five trends previously described, it rarely results in the filing of formal disciplinary charges. However, the lawyer may receive a cautionary letter highlighting the relevant ethical duties and responsibilities or outlining better accounting practices, or the Attorney Grievance Commission may issue an admonition letter, as provided for in MCR 9.114(B). An admonition letter, while confidential and not discipline, is meant to serve as a stern warning to the lawyer and will lead to heightened scrutiny of the lawyer's trust account practices if the Commission receives another overdraft notification. As of December 2014,



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106 admonishments have been issued as the result of trust account overdraft notifications.

Beyond an admonition letter, overdraft notifications and the ensuing investigations have resulted in the Commission's beginning public disciplinary proceedings. In certain instances of misconduct, such as knowing misuse of the trust account, the Commission may authorize the filing of a formal complaint against a lawyer and prosecute the complaint before the Attorney Discipline Board. As of December 2014, the Board has issued 32 notices of discipline in matters arising in whole or in part from overdraft notifications. Discipline has ranged from a reprimand to disbarment.

To avoid public discipline, lawyers should keep in mind the following:

- Accurately define your fee and ensure that it is deposited to the proper account. Fees paid in advance of services rendered are to be deposited to a trust account and then transferred to the business account as the fees are earned. Fees delineated as "earned upon receipt," "nonrefundable," "general retainer," or "engagement fee" are earned fees that should not be deposited to a client trust account. They should be deposited to the business account to avoid commingling.
- Maintaining earned fees in a lawyer's trust account or depositing the lawyer's own funds into his or her trust account constitutes commingling.
- Payment of law office, business, or personal expenses directly from a trust account is ethically impermissible even if the payment is from an earned fee. Leaving an earned fee in a lawyer trust account is commingling contrary to MRPC 1.15(d). Earned fees must be first transferred to a business account and expenses paid from that account.

- Acting as a personal banker for your client can raise many ethical concerns. Lawyers should be careful to avoid using a trust account to shield their client's money from creditors.
- Do not use your client trust account to avoid collection on tax liens or by other creditors. This statement might seem obvious, but the Attorney Grievance Commission has discovered a number of lawyers improperly using their trust accounts in this manner.
- Thou shalt not steal—from your client or anyone else. The Board has been very consistent in disbarring lawyers who knowingly convert or misappropriate funds not belonging to them.

Lawyers are, and must be, held to the highest standards when it comes to handling money or property of others. The State Bar, with input from the Attorney Grievance Commission staff, developed and regularly offers a half-day seminar focusing solely on trust accounting principles and recordkeeping resources. To date, the seminar has been attended by nearly 400 lawyers and their employees.

The Attorney Grievance Commission strives diligently to protect the public and the integrity of the legal profession from lawyers who engage in misconduct. The TAON rule is one tool at the Commission's disposal to ensure that lawyers are properly using their trust accounts. While formal disciplinary proceedings might be warranted in some circumstances involving the improper handling of a trust account, the Commission also seeks to educate the legal profession so lawyers can avoid receiving overdraft notifications and thus avoid the risk of formal disciplinary action. ■

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