



CLIENT TRUST ACCOUNT
Principles & Management
for Kentucky Lawyers

SECOND EDITION, 2010



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PREFACE

This second edition of the **Client Trust Account Principles & Management for Kentucky Lawyers** continues the joint effort of the Kentucky IOLTA Fund and Lawyers Mutual Insurance Company of Kentucky to provide Kentucky lawyers with information on their fiduciary obligation when they are entrusted with the property of clients, prospective clients, and third parties. It is directed primarily at sole practitioners and small firms, but the fiduciary principles and client trust account management guidelines covered are applicable to any size practice. It is proactive in concept by seeking to aid lawyers in the day-to-day management of client trust accounts in a way that meets their professional responsibility duties.

Client Trust Account Principles & Management for Kentucky Lawyers is a general guide only. It is not a publication of the Kentucky Bar Association and is not binding on those officials responsible for bar discipline. It should answer many basic questions about client trust accounts, but it is not a substitute for legal advice or for independent legal research on specific situations. Contacting the Kentucky Bar Association Ethics Hotline is urged in questionable situations (SCR 3.530). The Ethics Hotline is an invaluable service to the Bar that can help avoid a misstep in managing the property of others.

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Client Trust Account
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INTRODUCTION

Client trust account management is a unique aspect of a lawyer's professional responsibility. It involves specific fiduciary duties primarily administrative in nature. Violation of these duties is a matter of strict liability. A lawyer out of trust — the books do not balance or some other fiduciary duty is breached — has violated Kentucky Rule of Professional Conduct 1.15, Safekeeping Property (SCR 3.130), and is subject to discipline. Serious violations usually result in disbarment. Minor and temporary discrepancies may not result in discipline, but the fact remains that a fiduciary breach has occurred.

Complicating matters further many lawyers receive funds in other capacities such as trustee, guardian, personal representative of an estate, attorney-in-fact, and escrow agent. Does a lawyer have the same fiduciary obligation of safekeeping these funds as client funds? Finally, lawyers often receive valuable documents and personal property. What rules apply to safekeeping non-monetary property?

The intent of this guidebook is to provide information on the fiduciary obligation of Kentucky lawyers when they come into possession of the property of clients, prospective clients, and third parties. It is directed primarily at sole practitioners and small firms, but the fiduciary principles and client trust account management guidelines covered are applicable to any size practice. It is proactive in concept by seeking to aid lawyers in the day-to-day management of client trust accounts in a way that meets their professional responsibility duties. It should answer many general questions about trust accounts, but is not legal advice. Specific situations require research beyond what is available here. Contacting the Kentucky Bar Association (KBA) Ethics Hotline is urged in questionable situations (SCR 3.530). The Ethics Hotline is an invaluable service to the Bar that can help avoid a misstep in managing the property of others.

The information in this guidebook comes from a variety of sources. First, from the Kentucky law on client trust accounts that includes Rule 1.15, KBA ethics opinions on client trust accounts, and a number of Kentucky court opinions that order discipline in cases of client trust account mismanagement and misappropriation. Additional sources include other state client trust account guidebooks and general reference publications covering client trust accounts that are listed in Appendix A.

These definitions apply to the following terms used in this guidebook:

Bank: A bank that has agreed to notify the KBA when an overdraft occurs in a lawyer's client trust account.

Client Trust Account: An account established in a bank by a lawyer to safe keep funds entrusted to the lawyer when rendering legal services in a client-attorney relationship.

Dedicated Client Trust Account: A client trust account that is established in a bank for a single client. Dedicated accounts are typically established when client funds are large in amount and will be held long enough to earn interest for the client above the costs that would otherwise be incurred to generate such interest.

Pooled Client Trust Account: A client trust account that is established in a bank that consolidates funds from two or more clients in one account. Most firms routinely use pooled accounts for safekeeping client funds.

Fiduciary Trust Account: An account established by a lawyer for safekeeping funds entrusted to a lawyer when rendering professional fiduciary services such as trustee, guardian, personal representative of an estate, attorney-in-fact, and escrow agent.

Professional Fiduciary Services: Compensated services other than legal services provided by a lawyer as a trustee, guardian, personal representative of an estate, attorney-in-fact, or escrow agent, or in any other fiduciary role customary to the practice of law.

Rule or Rules: Refers to the Kentucky Rules of Professional Conduct, Supreme Court Rule 3.130, unless otherwise indicated.

Trust Account: An account established by a lawyer for safekeeping entrusted funds in connection with rendering legal services in a client-attorney relationship or when rendering professional fiduciary services.

INTRODUCTION

A. To What Funds or Property Does Rule 1.15 Apply?

The first thing every lawyer must do to assure compliance with client trust account requirements is to know and understand every aspect of Rule 1.15. This rule establishes the lawyer's fiduciary duty of safekeeping entrusted property and accounting for it. It applies to clients, prospective clients, and third party funds and non-monetary property received in connection with a representation or prospective representation (Rule 1.15, Comment (1)).

Rule 1.15 does not cover lawyers providing professional fiduciary services outside the practice of law. Comment (6) to Rule 1.15 provides: "The obligations of a lawyer under this Rule are independent of those arising from activity other than rendering legal services. For example, a lawyer who serves only as an escrow agent is governed by the applicable law relating to fiduciaries even though the lawyer does not render legal services in the transaction and is not governed by this Rule."

It is noteworthy that North Carolina requires lawyers providing professional fiduciary services to comply with North Carolina Rule of Professional Conduct 1.15 as well as any other fiduciary duties imposed by law. This approach is recommended as good risk management. Often lawyers act in a dual capacity providing professional fiduciary services as well as rendering legal advice regarding the entrusted funds. Even when the services are exclusively that of a professional fiduciary, if there is a loss of funds, the accusation often is that the lawyer was also rendering legal service in an attempt to invoke the lawyer's malpractice insurance. Experience teaches that lawyers are seldom successful in claiming they were acting completely outside their lawyer capacity. Invariably the facts show some minimal basis to allege that some legal service was provided. For this reason, voluntarily complying with Rule 1.15 in principle as well as all other fiduciary duties required by law is the best practice.

An important difference of not being governed by Rule 1.15 when serving as a professional fiduciary is that the fiduciary funds need not be deposited in a bank that has agreed to notify the KBA of overdrafts. This increases the options for earning income on the fiduciary funds

pending dispersal. If in doubt about professional responsibility requirements for safekeeping professional fiduciary funds, call the KBA Ethics Hotline.

B. Rule 1.15 Safekeeping Property

What follows is Rule 1.15 and official comments to it with emphasis added to stress key components:

(a) A lawyer shall hold property of clients or third persons that is in a lawyer's possession in connection with a representation separate from the lawyer's own property. **Funds shall be kept in a separate account maintained in the state where the lawyer's office is situated**, or elsewhere with the consent of the client, third person, or both in the event of a claim by each to the property. The separate account referred to in the preceding sentence **shall be maintained in a bank which has agreed to notify the Kentucky Bar Association in the event that any overdraft occurs in the account**. Other property shall be identified as such and appropriately safeguarded. **Complete records of such account 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.**

(b) **Upon receiving funds** or other property in which a client or third person has an interest, a lawyer **shall promptly notify the client, third person**, or both in the event of claims by each to the property. Except as stated in this Rule or otherwise permitted by law or by agreement with the client, third person, or both in the event of a claim by each to the property, **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 property.**

(c) When in the course of representation a lawyer is in possession of property 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 as to which the interests are not in dispute.

I. RULE 1.15 SAFEKEEPING PROPERTY AND RELATED RULES

(d) A lawyer may deposit the lawyer's own funds in a client trust account for the sole purpose of paying bank service charges on that account, but only in an amount necessary for that purpose.

(e) **Except for non-refundable fees as provided in 1.5(f), 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.**

Comment

(1) A lawyer should hold property of others with the care required of a professional fiduciary. Securities should be kept in a safe deposit box, except when some other form of safekeeping is warranted by special circumstances. **All property which is the property of clients or third persons, including prospective clients, must be kept separate from the lawyer's business and personal property and, if monies, in one or more trust accounts.** Separate trust accounts may be warranted when administering estate monies or acting in similar fiduciary capacities. A lawyer should maintain on a current basis books and records in accordance with generally accepted accounting practice and comply with any recordkeeping rules established by law or court order. See, e.g., ABA Model Financial Recordkeeping Rule.

(2) Lawyers often receive funds from which the lawyer's fee will be paid. The lawyer is not required to remit to the client funds that the lawyer reasonably believes represent fees owed. However, **a lawyer may not hold funds to coerce a client into accepting the lawyer's contention.** The disputed portion of the funds must be kept in a trust account and the lawyer should suggest means for prompt resolution of the dispute, such as arbitration. **The undisputed portion of the funds shall be promptly distributed.**

(3) Paragraph (c) describes the handling of disputes, including those between the lawyer and the client, the lawyer and third persons (or entities), and the client and third parties. Paragraph (c) recognizes that third parties may have lawful claims against specific funds or other property in a lawyer's custody, such as a client's creditor who has a lien on funds recovered in a personal injury action. A lawyer may have a duty

under applicable law to protect such third-party claims against wrongful interference by the client. In such cases, when the third-party claim is not frivolous under applicable law, the lawyer must refuse to surrender the property until the claims are resolved. Generally, if the claim is based on a contract obligation, writing signed by the client, statutory lien, court order, legal obligation to ensure payment to a third party employed by the attorney to provide services in furtherance of the client's claim, or other law, the lawyer may not disburse the funds until the dispute is resolved. In these circumstances the client should also be advised of the risks of not paying a valid claim. A lawyer should not unilaterally assume to arbitrate a dispute between the client and the third party, but, when there are substantial grounds for dispute as to the person entitled to the funds, the lawyer may file an action to have a court resolve the dispute.

(4) While normally it is impermissible to commingle the lawyer's own funds with client funds, paragraph (d) provides that it is permissible when necessary to pay bank service charges on that account. Accurate records must be kept regarding which part of the funds are the lawyer's. A lawyer may deposit funds in a trust account to provide funds for restitution of the defalcation caused by others, if necessary under any legal obligation to a banking institution, client or third party whose funds have been converted.

(5) Paragraph (e) requires that when a lawyer has collected an advance deposit on a fee or for expenses or a flat fee for services not yet completed, the funds must be deposited in the trust account until earned, at which time they should be promptly distributed to the lawyer. The foregoing shall not apply to nonrefundable fees. At the termination of the client-lawyer relationship the lawyer must return any amount held that was not earned or was an unreasonable fee, as provided by Rules 1.5 and 1.16(d).

(6) The obligations of a lawyer under this Rule are independent of those arising from activity other than rendering legal services. For example, a lawyer who serves only as an escrow agent is governed by the applicable law relating to fiduciaries even though the lawyer does not

I. RULE 1.15 SAFEKEEPING PROPERTY AND RELATED RULES

render legal services in the transaction and is not governed by this Rule.

C. Related Rules and Law

Several other rules of professional conduct have implications for proper client trust account management. The most significant is Rule 1.16, Declining or Terminating Representation. Paragraph (d) provides:

Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client's interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, **surrendering papers and property to which the client is entitled and refunding any advance payment of fee that has not been earned or incurred.** (emphasis added)

Other rules that are related to client trust account management are:

1. Rule 1.5, Fees;
2. Rule 1.8(a) concerning business transactions with clients, and (e) concerning financial assistance to clients;
3. Rule 5.1, Responsibilities of Partners, Managers and Supervisory Lawyers;
4. Rule 5.2 Responsibilities of a Subordinate Lawyer;
5. Rule 5.3, Responsibilities Regarding Nonlawyer Assistants;
6. Rule 8.4, Misconduct; and
7. SCR 3.820, Clients' Security Fund.

SCR 3.820 establishes a special fund for the "purpose of providing indemnification to clients who may suffer pecuniary loss by reason of fraudulent or dishonest acts on the part of a member of the Kentucky Bar Association." Eligible losses are limited to those caused by dishonest conduct on the part of a lawyer such as theft. Losses due to negligence are not covered. The rule also contains other limitations and restrictions and makes it clear that the payment of a claim is in the discretion of the fund's trustees and is not a matter of right. A copy of an Application for Relief may be obtained from the KBA Office of Bar Counsel. More information on the Clients' Security fund is available on the KBA's Website.

Comment (1) to Rule 1.15 provides in part: "A lawyer should maintain on a current basis books and records in accordance with generally accepted accounting practice and comply with any recordkeeping rules established by law or court order. See, e.g., ABA Model Financial Recordkeeping Rule." (See Appendix C for Model Rule.)

Cash transaction reporting laws also must be considered. The best known law is the federal requirement to report cash transactions of \$10,000 or more. It is imperative that lawyers remain current on all such legal requirements at both the state and federal level. (See IRS Publication 1544 (Rev. March 2009), Reporting Cash Payments of Over \$10,000 (Received in a Trade or Business).)

Finally, it should be noted that tort and criminal law concerning negligence, fraud, embezzlement, and theft might apply to client trust account fiduciary breaches. The fact that a lawyer is subject to bar discipline for a fiduciary breach does not preclude a client from bringing a civil action or government authorities from initiating a criminal prosecution for the same breach.

II. A DESCRIPTION OF RULE 1.15'S FIDUCIARY REQUIREMENTS

A. What It Means to be a Fiduciary

A lawyer's relationship with a client is from start to finish that of a fiduciary. This means that clients place a special trust and reliance in lawyers to act for the clients' benefit and not their own. Lawyers in turn must act in the utmost good faith and candor in all dealings with clients. This fiduciary duty is reflected in the overarching professional responsibility rules concerning client confidentiality and conflicts of interest. Rule 1.15 adds to these principles many of the common law requirements of principal and agent concerning agent accountability for a principal's property. Rule 1.15 thus gives the KBA the authority to discipline a lawyer for failing to properly account for client and third party property.

B. The Fiduciary Principles Summarized

The following overview of client trust account fiduciary principles is offered to help new lawyers understand the scope of Rule 1.15 and other lawyers and paralegals to review their firm's client trust account management system for compliance with these principles. This overview is supplemented in following sections with more specific information on managing client trust accounts.

1. You can delegate authority, but you can't delegate responsibility!

A lawyer in a firm in charge of representing a client is directly responsible for all funds and property received by the firm in connection with that representation. The internal management of funds and property may be delegated to other lawyers in the firm, usually a managing partner, or office staff. If things go wrong, however, the lawyer in charge no matter how junior in the firm, along with the managing partner or a lawyer who individually or together with other lawyers possesses comparable managerial authority in a firm, bears ultimate responsibility for a breach of fiduciary duties.

To meet this non-delegable responsibility lawyers must carefully supervise and train those in the firm tasked with the day-to-day management of entrusted property. Good supervision includes periodic employee performance reviews, use of outside auditors, financial management systems

that produce regular reports and records allowing close tracking of financial transactions, and use of internal controls to protect against fraud and theft. See Rule 5.1, Responsibilities of Partners, Managers and Supervisory Lawyers; Rule 5.2 Responsibilities of a Subordinate Lawyer; and Rule 5.3, Responsibilities Regarding Nonlawyer Assistants.

2. If the funds are not yours, they go into a client trust account — no exceptions.

The first step in safekeeping client funds is to meet the requirement to segregate them from firm funds and a lawyer's personal funds. This means depositing them in a bank account completely separate from firm operating accounts and lawyer personal accounts. There is no exception to this requirement. Practical difficulties such as a quick turnaround for disbursement do not excuse failure to deposit funds in a client trust account. Nor can the requirement be avoided by a lawyer personally holding the funds until dispersal. The value of this strict requirement for lawyers is that it creates an audit trail that affirmatively shows exactly how funds were dispersed.

3. Fiduciary "Job One" is safekeeping all property entrusted to the lawyer.

Client and third party funds are properly protected by complying with the requirement to segregate and account for them in a client trust account. Non-monetary client and third party property also must be protected. Comment (1) to Rule 1.15 provides that securities should be deposited in client safety deposit boxes, or if warranted, protected under some other special safekeeping arrangement. This is good policy for all valuable documents and non-monetary property suitable for deposit in a safety deposit box. Non-monetary property should be clearly marked showing to whom it belongs. Those for whom it is held should be told where it is located. There must be no commingling of client non-monetary property with a lawyer's business or personal property.

4. Lawyers must keep clients and third parties up-to-date on the receipt of entrusted property.

The Rule requires prompt notification of clients and third parties of receipt by a lawyer of funds

II. A DESCRIPTION OF RULE 1.15'S FIDUCIARY REQUIREMENTS

and property in which they have an interest. While "prompt" is subject to interpretation, lawyers who delayed notification for a matter of months received discipline for failure to promptly notify. The best practice is to notify as close in time to receipt of the property as notification reasonably can be made. The fact that the client has given the lawyer instructions on how received property is to be managed does not relieve the lawyer of the duty to notify that the property has been received.

5. Lawyers must be equally prompt in delivering to clients and third persons any entrusted funds or non-monetary property they are entitled to receive.

The key points to note about the prompt delivery requirement are:

- a. Prompt delivery applies to both clients and third persons;
- b. It includes both funds and non-monetary property; and
- c. Exceptions to prompt delivery are an agreement with the client for other than prompt delivery and funds in dispute. Disputed funds are to be held in the client trust account until the dispute is resolved. Management of disputed funds is discussed below.

Prompt is subject to interpretation, but lawyers have been disciplined for delays of five weeks, several months, and in extreme cases for delays of years. The best practice is to wait until all funds received by the lawyer for disbursement are unconditionally credited to the client trust account by the bank, records searches are updated, and all required documents executed. Then disburse as promptly as good business practice will permit.

6. A lawyer must provide a full accounting to a client or third person entitled to receive funds or other property upon request.

Full means full — a detailed breakdown of how funds and property were managed from receipt to disbursement. There are no shortcuts in complying with this duty.

7. The "complete records" requirement of Rule 1.15 means just that.

Compliance with Rule 1.15 requires a comprehensive management system of accounts and reports. The basics of what these should be are covered below.

8. Fiduciary duties are not over until the representation is over and all funds are dispersed.

Typically, a representation has an easily determined ending with appropriate statements of account rendered and all funds and property disbursed. Meeting fiduciary duties in these circumstances is largely a matter of routine. In those situations when the lawyer withdraws or is discharged by the client, however, fiduciary duties owed the former client are sometimes overlooked. It is important to remember that Rule 1.16(d) requires a lawyer in these circumstances to surrender papers and property to which the client is entitled and refund any advance payment of fees that have not been earned.

III. STRICT LIABILITY IS THE STANDARD FOR BREACH OF TRUST

A. *No Harm — Still a Foul!*

Lawyers have strict liability for any irregularity in a client trust account or mishandling of non-monetary property even though no client or third party suffers a loss. These irregularities range from theft to minor bookkeeping errors that are quickly corrected and harm no one. “No harm — still a foul” is the rule. Good intentions are not a defense to misappropriations of client funds — it is a per se offense. Poor supervision of nonlawyer staff, sloppy records, and dishonored client trust account checks are just a few of the mistakes that can occur that may result in bar discipline. While it is true that minor mistakes often do not result in discipline, a pattern of minor mistakes can result in serious sanctions. Any significant problem with a client trust account carries a high risk of suspension or disbarment.

B. *Misappropriation*

The most serious client trust accounts breaches are usually organized under the heading of misappropriation. In this context misappropriation is a term of art indicating:

1. **Conversion:** Examples of conversion are stealing, unauthorized temporary use of client funds regardless of purpose, check kiting, misapplying funds earmarked for a special purpose, failure to return unearned fees or unused client funds, improperly withholding fees from client funds, and using one client’s funds to pay another’s charges.

2. **Commingling:** Commingling occurs when a lawyer fails to segregate client and third party funds from funds of the firm or personal funds of the lawyer. This results in the client funds losing their separate identity. The fact that no funds are misapplied or are lost by a client does not excuse commingling

IV. THE BASICS OF CLIENT TRUST ACCOUNT TRANSACTIONS

A. *The Elements of a Client Trust Account*

1. What is a client trust account? An account separate from a lawyer's business or personal accounts in which the funds of clients and third parties the lawyer receives in connection with a representation must be deposited.
2. Where should the account be located? In the state in which the lawyer's office is located or elsewhere with the consent of the client or third person.
3. In what kind of financial institution must the account be established? In a bank that has agreed to notify the KBA of overdrafts.
4. How many accounts may a firm have? A firm may have dedicated accounts for individual clients and pooled accounts for multiple clients. If a pooled account is used, each client's funds in the account must be accounted for by the firm individually on a subsidiary ledger page of the pooled account journal (see Section VI. E. for an example of a pooled client trust account journal with client subsidiary pages). There is no limit on how many client trust accounts a firm may have. Dedicated client trust accounts for individual clients are often established because of the scope and complexity of the matter or because funds will be held long enough to earn income to which the client is entitled.

B. *Client Trust Account Deposit Rules*

1. Mandatory deposits: Funds belonging to a:
 - client,
 - lawyer and client or third party jointly,
 - client and third party jointly,
 - advance fees, and
 - advance expenses

must be deposited in a client trust account. When a lawyer receives a check that includes client funds and earned fees, the lawyer must deposit the entire amount in a client trust account and then immediately withdraw the earned fee portion of the amount deposited.

2. Non-refundable fees: Non-refundable fees are authorized in Rule 1.5, Fees, in the following provisions and are not deposited in a client trust account:

- Paragraph (f): A fee may be designated as a non-refundable retainer. A non-refundable retainer fee agreement shall be in a writing signed by the client evidencing the client's informed consent, and shall state the dollar amount of the retainer, its application to the scope of the representation and the time frame in which the agreement will exist.
- Comment (11): A lawyer may designate a fee arrangement as a non-refundable retainer and upon receipt deposit such funds in the lawyer's operating account. The amount of a non-refundable retainer fee must be reasonable in amount and comply with Rule 1.5.

3. Permissive deposits: Funds may be deposited in a client trust account to cover bank charges. Get an estimate from the bank on how much is required to cover this expense and make sure bank charge funds are replenished on a timely basis. It may be feasible to arrange for the bank to make automatic transfers from a firm account to a client trust account to cover bank charges. This removes the risk of using client funds to pay for bank charges for which they are not responsible. Be sure to account for funds deposited and expended for bank charges in a subsidiary bank charges ledger page as explained below.

4. Forbidden deposits: Firm funds, other than those for bank charges, and lawyer personal funds must not be deposited in a client trust account. The exception to this rule is when the funds received include client funds and earned lawyer fees. As explained above, funds of this nature must be first deposited in a client trust account with immediate disbursement from the account to the firm of the earned fees.

The simplest and safest approach to identifying when funds must go in a client trust account is to ask the question: "Whose money is it?" If the funds do not belong to the lawyer, they go into a client trust account. This includes unearned fees, fixed or flat fees that have not been fully earned, retainers,

IV. THE BASICS OF CLIENT TRUST ACCOUNT TRANSACTIONS

and advance expenses. As fees are earned the lawyer should make a prompt withdrawal to avoid a commingling problem. Expenses paid by the lawyer on behalf of a client should be reimbursed from the client trust account on a regular basis after expenditure.

C. Client Trust Account Disbursement Rules

1. Proper disbursement: Any disbursement not in dispute on a client's behalf including settlement and transaction proceeds, fees, costs, expenses, earned legal fees, and return of unearned fees is permissible.

2. Prompt disbursement: The rule requires prompt disbursement of funds to clients. To prudently disburse client funds a lawyer must have a thorough understanding of what is being deposited in an account, the state and federal laws allowing the bank to place a hold on funds, what the bank's routine holding period is, the time in which a payor may stop payment, how credit card deposits and chargebacks are applied to an account, and when funds are unconditionally available for disbursement. It is beyond the scope of this guidebook to go into the nature of the various negotiable instruments a lawyer might deposit in a client trust account. They include checks, cashier checks, drafts, collection items, certified checks, and money orders. Lawyers must discuss with their servicing bank all aspects of how deposited funds are managed, put on hold, dishonored, and unconditionally credited to an account.

Compliance with the prompt disbursement requirement becomes problematic when the availability of the funds in the client trust account is dependant on a deposited instrument that has not yet been collected. The best practice is to wait until all funds received by a lawyer for disbursement are unconditionally credited to the client trust account by the bank, any title searches updated, and all required documents executed. Then disburse as promptly as good business practice will permit. Explain this procedure to clients at the inception of the engagement and include it in letters of engagement so clients do not have unreasonable expectations about when they will receive funds.

3. Third party disbursements: Rule 1.15 also imposes a duty to promptly pay third parties.

Disputed third party claims are considered below.

4. Client instructions: Undisputed fund disbursements must be made in accordance with the client's latest instructions. A lawyer may not make a disbursement to pay a charge, claim, or lawyer's fee unless authorized by the client or disbursement is authorized by contract, statutory lien, court order, or other law. The best practice is to get advance approval for how and when funds will be disbursed at the inception of the representation in a letter of engagement signed by the client. Lawyers should:

- a. Get written authority to pay creditors with an interest in the recovery. This is particularly important for those the lawyer has personally engaged such as medical services required to develop a personal injury case. If the client gets all the recovery proceeds and fails to pay creditors, the lawyer could be liable. Almost as bad, it is the lawyer's credibility that suffers on the next case when seeking needed services.
- b. When disbursements are made to satisfy a contract obligation, statutory lien, court order, or other law, provide clients with the documents requiring disbursement.
- c. Get client approval before hiring experts and other high expense aspects of case preparation (i.e., don't surprise the client with a huge disbursement).
- d. Consider getting the client to pay large expenses directly while the case is ongoing and prior to final recovery disbursement. This simplifies things at the conclusion of the matter for all concerned.
- e. Confirm in writing with a creditor or third party claimant the exact amount due before advising a client to approve a disbursement.
- f. Never disburse funds to a client or third party before checks providing funds for the disbursement have been unconditionally credited to the client trust account.

IV. THE BASICS OF CLIENT TRUST ACCOUNT TRANSACTIONS

5. Disputed disbursements: The 2009 revision of Rule 1.15 provides much needed guidance on how to deal with disputed funds or non-monetary property held by a lawyer. The Rule contemplates these three dispute situations:

- client-lawyer;
- client-creditor; and
- lawyer-client's creditor

The first rule for disputes over property held by a lawyer is that the disputed property must be kept separate until the dispute is resolved:

Rule 1.15, paragraph (c): When in the course of representation a lawyer is in possession of property 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 as to which the interests are not in dispute.

Rule 1.15, Comment (3) provides detailed guidance on how to proceed in resolving the dispute:

Paragraph (c) describes the handling of disputes, including those between the lawyer and the client, the lawyer and third persons (or entities), and the client and third parties. Paragraph (c) recognizes that third parties may have lawful claims against specific funds or other property in a lawyer's custody, such as a client's creditor who has a lien on funds recovered in a personal injury action. A lawyer may have a duty under applicable law to protect such third-party claims against wrongful interference by the client. In such cases, when the third-party claim is not frivolous under applicable law, the lawyer must refuse to surrender the property until the claims are resolved. Generally, if the claim is based on a contract obligation, writing signed by the client, statutory lien, court order, legal obligation to ensure payment to a third party employed by the attorney to provide services in furtherance of the client's claim, or other law, the lawyer may not disburse the funds until the dispute is resolved. In these circumstances the client should also be advised of the risks of not paying a valid claim. A lawyer should not unilaterally assume to arbitrate a dispute between the client and the third party, but, when there are substantial grounds for dispute as to the person entitled to the funds,

the lawyer may file an action to have a court resolve the dispute.

Disputes may be resolved by persuasion, negotiation, private mediation or arbitration, the procedures of SCR 3.815, Mediation and Arbitration, and appropriate court proceedings.

Determining that a third party claim is frivolous under applicable law and not subject to the Rule 1.15 dispute procedures requires a cautious evaluation of the circumstances of the claim. There is no known Kentucky guidance on this question. States that have considered this issue have concluded that a bare assertion of a claim against client funds is not enough to preclude disbursement to the client. Further, the lawyer has no obligation to investigate the merits of the third party's claim. When in doubt on treating a disputed claim as frivolous, call the KBA Ethics Hotline for guidance.

V. CLIENT TRUST ACCOUNT MANAGEMENT SPECIAL CONSIDERATIONS

A. Should Fiduciary Funds be held in a Pooled Client Trust Account, Dedicated Client Trust Account, or Fiduciary Account?

Many lawyers provide professional fiduciary services such as trustee, guardian, personal representative of an estate, attorney-in-fact, and escrow agent. In some cases the lawyer provides legal services along with fiduciary services. In other cases no legal services are involved and the lawyer is compensated solely for professional fiduciary services; *e.g.*, escrow agent. This presents the question of whether funds held by a lawyer performing these services should be deposited in a client trust account (pooled or dedicated) or a fiduciary account separate and distinct from all law firm client trust accounts.

Notwithstanding Rule 1.15, Comment (6) that provides "... a lawyer who serves only as an escrow agent is governed by the applicable law relating to fiduciaries ... and is not governed by this Rule," Comment (1) to the Rule appears to allow funds received by a lawyer acting as only a professional fiduciary to deposit funds in a client trust account:

All property which is the property of clients or third persons, including prospective clients, must be kept separate from the lawyer's business and personal property and, if monies, in one or more trust accounts. Separate trust accounts may be warranted when administering estate monies or acting in similar fiduciary capacities.

Depositing professional fiduciary funds in a client trust account is apparently not prohibited and may be a satisfactory way of safekeeping these funds if the lawyer is otherwise in compliance with laws governing fiduciaries. There are, however, several reasons why this is not good policy:

- First, fiduciary funds are often in large amounts and held for an appreciable period of time. If this is the case, the funds should be deposited in income producing accounts and are not suitable for a pooled client trust account. A dedicated client trust account or a fiduciary account should be used depending on whether legal services are being provided in connection with holding fiduciary funds. The best practice when the amount to be

deposited is large and will be held more than a few days is to get client instructions on how the funds are to be deposited and with what security.

- Second, the recordkeeping requirements for fiduciary funds will often necessitate that they be deposited in a separate fiduciary account. This approach gives higher visibility to fund accountability and reduces the risk of errors or that fiduciary funds will become commingled with client funds.
- Finally, if the professional fiduciary services funds are deposited in a client trust account in circumstances when the lawyer is providing no legal services, the capacity in which the lawyer is serving becomes blurred. This could result in the lawyer being held to have acted as both professional fiduciary and lawyer thereby increasing the lawyer's risk exposure to a malpractice claim as well as a professional fiduciary breach of trust claim. Fiduciary funds held in a fiduciary account clearly distinguishable from a client trust account is the best evidence that the lawyer was acting only as a professional fiduciary.

B. Bank Interest

Lawyers may not earn interest on client trust account funds or use earned interest to pay for bank charges on the account. Interest earned on client trust accounts is treated as follows:

- Pooled Client Trust Accounts: Kentucky lawyers, unless otherwise exempt, are required to participate in the Interest On Lawyers' Trust Accounts (IOLTA) program established by the recently amended SCR 3.830. This program allows interest earned by pooled client trust accounts to be paid to the IOLTA Fund and used to finance law-related public interest projects. The IOLTA program is the subject of Section VII of this guidebook.
- Dedicated Client Trust Accounts: A client's funds should be deposited in a dedicated client trust account and not deposited in an IOLTA account when either the amount or the period of time that the funds are held would

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earn for the client interest above the costs that would otherwise be incurred to generate such interest. See Section VII, Paragraph F.

C. Bank Service Charges

Bank service charges that are directly attributable to a particular client such as wire transfers may be paid from that client's funds provided the client has agreed to pay them. Bank service charges on pooled accounts for checks and monthly fees are not attributable to a particular client. These are general administrative expenses of the lawyer and may not be passed on to the client. Rule 1.15(d) permits lawyers to deposit firm funds in client trust accounts to minimize bank service charges and avoid misappropriation of client funds. It is feasible with some banks to link firm operating accounts to client trust accounts for automatic replenishment of funds necessary to cover bank charges. This procedure avoids even brief improper use of client funds to cover bank service charges.

D. Insuring Client Trust Accounts — FDIC

Rule 1.15 does not require that client trust accounts be insured by the FDIC, but the Interest on Lawyers' Trust Accounts (IOLTA) program (SCR 3.830) in which Kentucky lawyers are required to participate does:

"An IOLTA account shall be established with a participating financial institution (i) authorized by federal or state law to do business in Kentucky, and (ii) insured by the Federal Deposit Insurance Corporation or its equivalent."

If a lawyer is exempt from participating in the IOLTA program, it is good risk management practice nonetheless to deposit all client funds in banks that are insured by the FDIC. If the funds in an account exceed the current \$250,000 FDIC coverage, be sure the bank has adequate other insurance. Confirm this in writing. In some cases it may be necessary for the lawyer to purchase firm insurance for the account or to open additional accounts in other banks to adequately protect client funds. It is always good practice to get client instructions on how large amounts are to be deposited and with what security.

The FDIC on its Website "Your Insured Deposits — FDIC's Guide to Deposit Insurance Coverage" (*last viewed on 11/20/2009*) provides this guidance on insurance limits and how to acquire up to \$250,000 insurance for the funds of each client held in a pooled client trust account:

- **Insurance limits:** Depositors at FDIC-insured institutions that have elected to participate in the Transaction Account Guarantee Program (TAG) have unlimited insurance coverage on IOLTA account deposits until June 30, 2010. At that time, the insurance coverage will revert to \$250,000 per depositor through December 31, 2013. Those financial institutions electing not to participate in TAG, have their deposits insured to at least \$250,000 per depositor through December 31, 2013. Under each of these circumstances, as of January 1, 2014, the standard insurance amount will return to \$100,000 per depositor for IOLTA accounts.
- Procedures for acquiring FDIC insurance for each client in a pooled client trust account are covered in the following paragraphs from the FDIC Guide:

What are fiduciary accounts? These are deposit accounts owned by one party but held in a fiduciary capacity by another party. Fiduciary relationships may include, but are not limited to, an agent, nominee, guardian, executor, or custodian. Common fiduciary accounts include Uniform Transfers to Minors accounts, escrow accounts, Interest On Lawyer Trust Accounts (IOLTA), and deposit accounts obtained through a broker.

What are the FDIC disclosure requirements for fiduciary accounts? The fiduciary nature of the account must be disclosed in the bank's deposit account records (*e.g.*, "Jane Doe as Custodian for Susie Doe" or "First Real Estate Title Company, Client Escrow Account"). The name and ownership interest of each owner must be ascertainable from the deposit account records of the insured bank or from records maintained by the agent (or by some person or entity that has agreed to maintain records for the agent). Special disclosure rules apply to multitiered fiduciary

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relationships. If an agent pools the deposits of several owners into one account and the disclosure rules are satisfied, the deposits of each owner will be insured as that owner's deposits.

How does the FDIC insure funds deposited by a fiduciary? Funds deposited by a fiduciary on behalf of one or more persons or entities (the owners) are insured as the deposits of the owners if the fiduciary meets the disclosure requirements for fiduciary accounts. (See no.18.)

Would funds deposited by a fiduciary be insured separately from the owners' other accounts at the same bank? Funds deposited by a fiduciary on behalf of one or more persons or entities (the owners) would be added to any other deposits of the owners at the same insured bank and the total would be subject to the insurance limit for the applicable ownership category. For example: A broker purchases a CD for \$250,000 on a customer's behalf at ABC Bank in the customer's name alone and the customer already has a checking account in his or her name alone at that same bank for \$15,000. The two accounts would be added together and insured up to a total of \$250,000 in the single ownership account category, with \$15,000 uninsured.

The FDIC's Website, www.fdic.gov, should be consulted when opening a trust account and regularly thereafter for any changes in insurance coverage and to assure compliance with FDIC requirements for pooled client trust accounts.

E. Check Signature Authority

The authority to sign client trust account checks may be delegated to office staff, but this practice is discouraged by risk managers and by the ABA's Model Rule on Financial Recordkeeping cited in Rule 1.15, Comment (1). The Model Rule provides that "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...."

The recommended practice is for a lawyer, usually the managing partner or lawyer who individually or together with other lawyers possesses comparable managerial authority in a firm, to sign all checks. Do not use signature stamps or computer-generated signatures. Do not use ATMs to withdraw or deposit client funds because unauthorized persons may gain access to the card and an adequate paper record is not generated by ATM receipts. There is no implied authority for a lawyer to sign a client's signature on a check. Doing so without authority is conversion of client funds.

F. Overdraws and Overdrafts

An overdraw occurs when funds of one client are erroneously expended for the benefit of another client from a pooled client trust account. An overdraft occurs when a check is dishonored for lack of sufficient funds in the account. In either circumstance the lawyer is out of trust and in violation of Rule 1.15. Immediately upon discovering the problem the lawyer must take corrective action by depositing funds in the client trust account to bring it back into balance. Cause of the overdraw or overdraft should be determined, corrected, and documented.

G. KBA Overdraft Notification Requirement

Rule 1.15 (a) requires that client trust accounts be maintained in a bank that has agreed to notify the KBA of any overdraft. The KBA Office of Bar Counsel has defined an overdraft as:

"... an overdraft occurs whenever a properly payable instrument is presented against an account which contains insufficient funds to pay the instrument in full. It does not matter whether the instrument is actually dishonored or paid. When an overdraft occurs, it must be reported to the KBA. The bank does not need to concern itself with the circumstances of the overdraft or the reason it occurred, because the KBA will investigate to determine whether any further action is necessary."

Bank overdraft notices will trigger an inquiry by Bar Counsel, but an overdraft notice is not treated as a complaint until after the inquiry indicates this is appropriate.

To comply with this requirement a lawyer must:

V. CLIENT TRUST ACCOUNT MANAGEMENT SPECIAL CONSIDERATIONS

1. Submit to the KBA Office of Bar Counsel a letter from the depository bank confirming the bank's agreement to notify the KBA when an overdraft occurs in any client trust account.
2. The letter should identify each account by name and number and include a bank contact person.
3. A bank overdraft notification must be in writing and addressed to: Kentucky Bar Association, Office of Bar Counsel, 514 West Main Street, Frankfort, Kentucky 40601. It should include sufficient information about the overdraft to initiate an inquiry to include:
 - a. Name of the lawyer (or firm).
 - b. Account name and number.
 - c. Date and amount of the overdraft.
 - d. A duplicate copy of the overdraft (or NSF) notice sent to the payee.

It should be noted that lines of credit or other overdraft protection arrangements with a bank that prevent the dishonor (bouncing) of a client trust account check do not excuse the bank from notifying the KBA of an overdraft. The reason for this position is explained in the ABA Model Rules for Trust Account Overdraft Notification, Rule 2, which provides:

In light of the purposes of this rule, and the ethical proscriptions concerning the preservation of client funds and commingling of client and lawyer funds, it would be improper for a lawyer to accept "overdraft privileges" or any other arrangement for a personal loan on a lawyer trust account.

Do not enter overdraft protection agreements with banks for client trust accounts.

The KBA Website information on overdraft reporting has a form that may be used for a lawyer-bank overdraft-reporting agreement. A copy of the executed agreement must be sent to the Office of Bar Counsel.

H. Outstanding Checks

Client trust account checks not cashed for an appreciable period of time are a nuisance and can lead to errors in account management. This may also be an indication that the account includes unclaimed funds. There are various ways of coping with this problem to include printing on checks "Void after 90 days," contacting payees by telephone or certified mail if a large amount is involved, and placing a stop payment order on a check. None of these approaches are guaranteed to solve the problem — in the automated banking world of today checks are often negotiated well after action has been taken to void them. It is important to coordinate with the bank to be clear on how bank procedures work and seek extra service in identifying voided outstanding checks.

I. Unclaimed Funds and Non-Monetary Property

It is not unusual for a lawyer to be in possession of property belonging to a client or third party with whom the lawyer has lost contact. In these circumstances the lawyer is required to continue to safe keep this property just as any other client property. A diligent effort must be made to locate the owner and deliver the funds or non-monetary property. These efforts include calling the client's employer, visiting last known addresses, talking to neighbors, and attempting to make contact by phone, mail, internet, and through newspaper notices. Beverly Michaelis in her article "I Can't Find My Client" advises that good practice is to get key location information from the client at the time the representation is undertaken. Be sure to get addresses, telephone numbers, names of people who will know where the client will be, social security numbers, drivers license numbers, and dates of birth. With impaired clients it is often helpful to get the names and numbers of professionals assisting the client with health problems, e.g., health care providers and government agencies working with the impaired client.

If unsuccessful in locating a client, the lawyer may seek a judicial determination for disposition or follow Kentucky's abandoned property law. KRS 393.020 provides that property abandoned by an owner vests in the state, subject to all legal and equitable demands. KRS 393.066 sets up

V. CLIENT TRUST ACCOUNT MANAGEMENT SPECIAL CONSIDERATIONS

a presumption of abandonment for intangible property held by a fiduciary if no contact has been made within three years:

393.066 Presumption of abandonment of intangible personal property held by fiduciary.

All intangible personal property and any income or increment thereon, held in a fiduciary capacity for the benefit of another person is presumed abandoned unless the owner has, within three (3) years after it becomes payable or distributable, increased or decreased the principal, accepted payment of principal or income, corresponded in writing concerning the property, or otherwise indicated an interest as evidenced by a memorandum on file with the fiduciary:

- (1) If the property is held by a banking organization or a financial organization, or by a business association organized under the laws of or created in this state; or
- (2) If it is held by a business association doing business in this state, or any agent or fiduciary acting for or under contract with a business association doing business in this state, but not organized under the laws of or created in this state, and the records of the business association indicate that the last known address of the person entitled thereto is in this state; or
- (3) If it is held in this state by any other person

Escheat procedures are in 20 KAR 1:030 Unclaimed property; escheating.

J. Credit Card Deposits

Payment by credit card for legal services performed by law firms was approved in KBA E-172 (1977). This opinion is one of first impression concerning the basic question of whether credit card payments may be accepted at all by law firms in Kentucky. It did not consider many ethical issues concerning credit card fee collection. KBA E-426 (2007) fills the gap by providing both the professional responsibility guidance and the client trust account management considerations required to confidently accept credit card payments. The full text of the opinion is in Appendix B.

One question not addressed in KBA E-426 was: Is it permissible to arrange for automatic charges against a client's credit card? This question was discussed as follows in the article "Credit Cards, Firm Trust Accounts, and Thou," (*Bench & Bar*, Vol. 67, No.6, Nov. 2003, available on Lawyers Mutual's Website at www.lmick.com — go to the Risk Management/Bench & Bar Articles page):

The Missouri, South Carolina, and Nassau County (N.Y.) bars permit automatic credit card charges (*i.e.*, without the client signing the credit card slip) if the client agrees. The key consideration in all three states is clarity of client communications. It is not enough simply to include automatic credit card charges as part of the terms in a letter of engagement. A lawyer must discuss the procedure with the client and get specific approval. A receipt must be sent to the client notifying of the charge. South Carolina requires that the client be sent a bill for review before making the pre-authorized charge against the credit card. Nassau County requires a written agreement if charges are for prospective services.

By following the procedures developed in other states for automatic credit card payments, Kentucky lawyers should meet ethical requirements of client communication and fair dealing. Nonetheless, it is an aggressive method of collecting fees that suggests a call to the KBA Ethics Hotline is in order before employing automatic credit card charge procedures. (footnotes omitted)

K. File Retention Requirements

Rule 1.15(a) requires that: "Complete records of ... [client trust] account 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." Lawyers Mutual, however, recommends a 10-year retention period and longer if the statute of limitations has not run on the matter during the 10-year period. Some files could require even longer retention to include permanent retention. For more information on file retention read *The Secret Life Of Client Files*, KBA *Bench & Bar*, Vol. 67, No.1, Jan. 2003, available at www.lmick.com in the Risk Management *Bench & Bar* Articles page.

V. CLIENT TRUST ACCOUNT MANAGEMENT SPECIAL CONSIDERATIONS

L. Use of Computers for Client Trust Account Management and Recordkeeping

There is no prohibition against using computers to compile client trust account records. Numerous affordable computer software programs are available that offer all the functions needed to properly administer client trust accounts. Given the efficiency and accuracy of these programs they are a great improvement over a manual system. It is essential to backup trust account data daily and maintain an off-site storage facility for this data that is refreshed at least weekly.

The question arises whether client trust account records may be maintained exclusively in electronic format eliminating the storage of voluminous paper files. Rule 1.15, Comment (1) provides in part:

“A lawyer should maintain on a current basis books and records in accordance with generally accepted accounting practice and comply with any recordkeeping rules established by law or court order. See, e.g., ABA Model Financial Recordkeeping Rule.”

The cited ABA Model Financial Recordkeeping Rule provides the following guidance on electronic files:

“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.”

It appears from these provisions that Kentucky lawyers have a basis for maintaining trust account records in electronic format and do not have to create paper records except on an as needed basis. Note that original client documents entrusted to a lawyer must be maintained in their original form. It is recommended that the KBA Ethics Hotline be called to confirm this conclusion before maintaining client trust account records exclusively in electronic format.

M. Client Trust Account Scams

Lawyers are frequently the target of scams that, if effective, result in losses in client trust accounts and violations of trust account fiduciary rules. Real estate, litigation, and wills and estate lawyers are primary targets, but all lawyers should expect a scam attempt. The Lawyers’ Professional Indemnity Company (LawPro) is doing outstanding bar service by providing information and guidance on scams. LawPro’s fact sheet “*Fraud — How to avoid becoming its next victim*” offers the following advice:

“Fraudsters retain the firm on a contrived legal matter so that they can run a counterfeit check or bank draft through the firm trust account and walk away with real money. When the bad check or draft bounces, there will be a shortfall in the trust account.

Business loan fraud

- New client retains your firm’s services to help with buying small business equipment or inventory.
- Documentation in client’s file looks real (invoices, letters, etc).
- Background checks (corporate or PPSA searches) may look normal.
- You’re asked to represent lender and borrower.
- Certified check from “lender” arrives promptly, gets deposited to your trust account.
- Certified check looks authentic and has all normal security features.
- Funds are disbursed to the client.
- Days later your bank tells you the check/draft is fraudulent.

Debt collection fraud

- Generally targets litigators.
- New client (often offshore) contacts your firm seeking representation on a debt collection.
- Client provides legitimate documentation including invoices, demand letters, etc.
- Collection is hassle-free; debtor returns calls and pays up promptly.
- Certified check looks authentic and has all normal security features.
- You’re instructed to send funds, minus legal fees, to an offshore account.
- Days later your bank tells you the check/draft is fraudulent.

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RED FLAGS

- Client is offshore, unknown to the firm and/or in a rush — pressures you to “do the deal” quickly.
- Client willing to pay higher-than-usual fees on a contingent basis from (bogus) funds you are to receive.
- Client shows up around banking holidays — when banks are closed and offices short-staffed.
- Debtor pays without any hassle — unusual given client’s need to retain you to get payment in the first place.

TIP: DIG DEEPER

- Do a reverse phone number search on the company and use Google to verify phone numbers, addresses and e-mail contacts.
- Contact the company to confirm that they are expecting debtor’s payment or business loan.
- Go to bank website to verify branch transit number, address and phone number on the check.
- Hold funds until your bank confirms the funds are “good” by contacting the other bank, and it’s safe to withdraw the deposit.”

Go to LawPro’s Website (*last viewed on 9/29/2009*) www.practicepro.ca/fraud for the rest of this article and many other highly useful articles on dealing with fraud from both within and without the firm.

The problem for lawyers who make a disbursement from a client trust account based on a counterfeit check is that it involves them in a fraud and makes them responsible for restoring the transferred funds since the likelihood of recovering the funds is nil. The best risk management practice with any check deposited in a client trust account is to make no disbursements on it until the check clears regardless of its apparent validity. Currently, bank failures are frequent making this practice even more important. Advise clients at the inception of a representation in a letter of engagement that they will not receive funds until a check received in payment of their matter clears. Put this in your letter of engagement.

VI. CLIENT TRUST ACCOUNT RECORDKEEPING

A. What Constitutes an Adequate System of Account?

Rule 1.15 provides that: "Complete records of ... [*client trust*] account 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." Unfortunately, while the Rule establishes strict standards for managing and accounting for client and third party property, neither the rule nor the KBA provide the details of how this is to be done. This section attempts to fill the gap by offering a basic recordkeeping system for the typical Kentucky lawyer's need to account for funds held in dedicated client trust accounts, funds held in pooled client trust accounts, and entrusted non-monetary property.

An adequate system includes:

1. Retention of documents to support account transactions.
2. A chart of accounts to record transactions.
3. Preparation of reports and records for account reconciliation, client information and notification, audits, and response to KBA inquiries.
4. A filing system that assures that required documentation is retained for at least five years after the end of the representation and all funds disbursed.

B. Supporting Documentation

Over the years various authorities have developed lists of documents lawyers should retain to support client trust account recordkeeping. What follows is a gloss of some of these lists and the ABA Model Financial Recordkeeping Rule recommendations.

1. Documents that should be retained to support client trust account transactions:

- Client instructions or authorizations to disburse funds from the trust account.
- When feasible prenumbered canceled checks or their equivalent and other instruments drawn on the account.
 - The Check Clearing for the 21st Century Act does away with the ability to receive original canceled checks. Under this law a bank may provide an image replacement document called a "substitute check" instead of the original check. A substitute check is the legal equivalent of the original check for all purposes — federal law, state law, and all persons — provided it contains all the information on the front and back of the check when it was removed (truncated) from the check collection process and complies with certain other technical requirements. ("Check 21 Act" — 12 U.S.C. 5001, Pub. L. No. 108-100, 117 Stat. 1177 Oct. 28 2003)
- It is beyond the scope of this guidebook to cover the specifics of the Check 21 Act. Lawyers need to understand how under this law original checks are truncated, what happens to the original check, how substitute checks are created, what bank warranties on substitute checks are, what drawer recredit rights are, what bank liability is, what remedies bank customers have, and the Act's relationship to other laws.
- Bank notices of wire transfers in and out of the account.
- Checkbooks and check stubs or their equivalent.
- Deposit slips listing the source and date of receipt of funds to include funds deposited by a lawyer to minimize bank charges. Deposit slips for pooled client trust accounts must identify the client to whom the funds belong.
- Bank statements and bank notices of dishonored checks.
- Copies of statements, notifications, and bills sent to clients.
- Copies of statements showing payments to third parties and lawyer charges for fees and costs.
- Copies of all letters of engagement and retainer and compensation agreements.
- Any other document needed for understanding a transaction.

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2. ABA Model Financial Recordkeeping Rule has this guidance on records retention:

A lawyer who practices in this jurisdiction shall maintain current financial records as provided in this 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.

There are a variety of ways to file and organize documents for trust accounts. Journal and ledger notebooks with file pockets for checks and deposit slips are commonly used. The key is to have a routine system for filing supporting documents for each trust account. Be sure to file supporting documents separately for each client with funds in a pooled trust account. This procedure facilitates correcting errors and providing clients with an accounting when requested. Any good office supply store will have several satisfactory filing systems.

C. Bookkeeping System

Bookkeeping system refers to the check registers, ledgers, and journals a lawyer uses to account for client funds. While a variety of names are used for similar procedures, the functions that must be performed are:

1. **Dedicated Client Trust Account Ledger:** A record of all transactions in an account established for a single client. A subsidiary ledger page is required to record funds that a lawyer deposits to pay for bank charges on the dedicated account.
2. **Pooled Client Trust Account Journal:** A record of all transactions in an account established for more than one client.
3. **Subsidiary Ledgers:** A Pooled Client Trust Account Journal requires a subsidiary ledger page for each client whose funds are deposited in the pooled account and a subsidiary ledger page to record funds that a lawyer deposits to pay for bank charges on the pooled account.
4. **Checkbook Register:** The register used to record checks as they are written on a client trust account comparable to the check stub book used for personal bank accounts.

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5. Non-Monetary Property Journal: A record of all transactions involving valuable documents, securities, jewelry, and other personal property entrusted to a lawyer.

charges for the dedicated account should be recorded on a bank fees and charges subsidiary ledger page.

D. Dedicated Client Trust Account Ledger

Lawyers must keep a separate ledger of all receipts and disbursements related to each client. When the account pertains to only one client, a dedicated client trust account ledger along with the account checkbook register and supporting documents are a sufficient record for that account. Any funds the lawyer deposits to pay for bank

A dedicated client trust account ledger should identify the client for whom the funds are held. Each deposit should be recorded by date, source of funds, and amount. All disbursements should be recorded by date, check number, amount, payee, and purpose of disbursement. The ledger should provide sufficient space for further information on the transaction if appropriate. Finally, after each transaction is entered, the ledger should show a running balance of that client's funds.

Dedicated Client Trust Account Ledger

Client Name/File Number: Jim Davis — File# 2009-12345

Matter/Adverse Party: Auto crash injury — Joe Doe

Date	Transaction/Memo	Check#	Disbursement	Deposit	Balance
8/1/09	Beginning balance				\$1,750
8/3/09	AIG settlement			\$50,000	\$51,750
8/8/09	Memorial Hospital — surgery 7/6/04	121	\$20,000		\$31,750
8/8/09	Settlement proceeds to client	122	\$20,000		\$11,750
8/9/09	Firm Fees	123	\$10,000		\$1,750

A copy of the client ledger is often used by lawyers for accounting to the client. This dual purpose should be considered when designing the format of client ledgers and when making explanatory entries in the ledgers. For example, the names of court reporters and medical

records companies will not be familiar to clients, therefore, additional explanation is necessary for an understanding by the client of how funds were spent. The following is an illustration of one way to set up a dedicated client trust account ledger:

Bank Fees and Charges Subsidiary Ledger Page

Client Name/File Number: Jim Davis — File# 2009-12345

Matter/Adverse Party: Auto crash injury — Joe Doe

Date	Purpose	Bank Charge	Firm Deposit	Balance
8/1/09	Beginning month balance			\$100
8/15/09	Check printing	\$30		\$70
8/25/09	Quarterly fee	\$40		\$30
8/29/09	Replenish funds		\$70	\$100

VI. CLIENT TRUST ACCOUNT RECORDKEEPING

E. Pooled Client Trust Account Journal

This journal is used to account for all client balances maintained in a pooled account. The journal should identify the name of the bank, the name of the account, and the account number. The journal should show for deposits each item deposited, the date, amount, source of funds, and name of the client whose funds are involved. When a disbursement is made the journal should show the date, check number, payee, amount, purpose of disbursement, and name of client whose funds are involved.

The pooled account journal requires a separate subsidiary ledger page for each client whose funds are deposited in the account. The client subsidiary ledger page shows each deposit of that client's funds by date, source of funds and amount. All disbursements of the client's funds are recorded by

date, check number, amount, payee and purpose of disbursement. The subsidiary ledger page should provide sufficient space for further information on a transaction if appropriate. Finally, after each transaction is entered, the ledger page should show a running balance of that client's funds.

The total of all client subsidiary ledger page balances must equal the total of the account journal balance. If lawyer funds are deposited to minimize bank charges or cover service fees or charges, this should be recorded in the account journal and a separate subsidiary bank charges ledger should be established for these transactions.

The following is an illustration of one way to set up a pooled client trust account journal with subsidiary ledgers for each client and bank charge deposits and expenditures:

Pooled Client Trust Account Journal

Jones & Jones Pooled Client Trust Account
Bank: PN-ONE

Number: 123456

Date	Check # Account	Client Sub Source Memo	Payee Charge Amount	Check/ Amount	Deposit	Balance
8/1/09			Beginning month balance			\$50,000
8/2/09	123	Doaks 07-987	Dr. Smith payment	\$500		\$49,500
8/3/09		Shelby 08-654	State Farm settlement		\$30,000	\$79,500
8/9/09	124	Shelby 08-654	Settlement check to client	\$20,000		\$59,500
8/9/09	125	Shelby 06-654	Firm fee	\$10,000		\$49,500
8/15/09		Bank fees	Check printing	\$30		\$49,470
8/25/09		Bank fees	Quarterly fee	\$40		\$49,430
8/29/09		Bank fees funds	Firm replenish		\$70	\$49,500
8/31/09			End of month balance			\$49,500

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Client Trust Account Subsidiary Ledger Page

Jones & Jones Pooled Client Trust Account Number: 123456

Client Name: J. D. Shelby
 Matter: Car accident injury

File Number: 01-654
 Adverse Party: John Doe

Date	Transaction/Memo	Check#	Disbursement	Deposit	Balance
8/1/09	Beginning month balance				\$1,500
8/3/09	State Farm settlement			\$30,000	\$31,500
8/9/09	Settlement proceeds to Shelby	124	\$20,000		\$11,500
8/9/09	Jones & Jones fee	125	\$10,000		\$1,500

Bank Fees and Charges Subsidiary Ledger Page

Jones & Jones Pooled Client Trust Account Number: 123456

Bank: PN-ONE

Date	Purpose	Bank Charge	Firm Deposit	Balance
8/1/09	Beginning month balance			\$150
8/15/09	Check printing	\$30		\$120
8/25/09	Quarterly fee	\$40		\$80
8/29/09	Replenish funds		\$70	\$150

F. Non-Monetary Property Ledger

The following is an illustration of one way to set up a non-monetary property ledger:

Non-Monetary Property Ledger

Jones & Jones Entrusted Non-Monetary Property Ledger

Client	Property	Date Received	Date Returned	To Whom
Joe Smith	Diamond ring	8/9/09	6/23/04	Joe Smith
Jane Doe	IBM stock cert.-100s	8/23/09		

VI. CLIENT TRUST ACCOUNT RECORDKEEPING

G. Monthly Client Trust Account Reconciliation Report

All client trust account checkbook registers, dedicated client trust account ledgers, pooled client trust account journals, and subsidiary ledgers should be reconciled monthly when bank statements are received and never less frequently than quarterly.

A dedicated client trust account reconciliation consists of adding any bank fees and charges subsidiary ledger balance to the client ledger balance and matching this total with the reconciled bank statement balance. The steps in reconciling dedicated accounts are shown in the following simplified report that is adapted from a model report developed by the Wisconsin Bar Association.

Monthly Dedicated Client Trust Account Reconciliation Report

For the month of: _____

1. Client ledger balance:	_____	
2. Bank fees and charges subsidiary ledger balance	_____	
3. Total ledger and subsidiary ledger balances *	_____	_____*
4. Account bank statement balance	_____	
(-) outstanding checks:	_____	

(+) unlisted deposits:	_____	

5. Bank statement reconciled balance*	_____	_____*

** The client ledger and the bank fees and charges subsidiary ledger total balances and the reconciled bank statement balance must be the same.*

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The monthly reconciliation report for a pooled client trust account must show that the subsidiary ledgers balance with the account journal balance and that the account journal balances with the bank statement. The steps in reconciling pooled accounts are shown in the following simplified report that is adapted from a model report developed by the Wisconsin Bar Association.

Monthly Pooled Client Trust Account Reconciliation Report

For the month of: _____

	<u>Totals</u>	
1. Client subsidiary ledger balances:		
Client A	_____	
Client B	_____	
Client C	_____	
Etc.	_____	
2. Bank fees and charges subsidiary ledger balance	_____	
3. Total all subsidiary ledger balances*		_____*
4. Pooled Client Trust Account Journal balance*		_____*
5. Account bank statement balance	_____	
(-) outstanding checks:	_____	

(+) unlisted deposits:	_____	

6. Bank statement reconciled balance*		_____*

** The subsidiary ledgers balance, account journal balance, and reconciled bank statement balance all must be the same.*

VII. INTEREST ON LAWYERS' TRUST ACCOUNTS FUND (IOLTA)

A. *The IOLTA Program.* The Kentucky IOLTA (Interest on Lawyers' Trust Accounts) Fund was established in 1986 by Kentucky Supreme Court Rule 3.830. The complete text of SCR 3.830 as amended in 2009 is at Appendix D. The IOLTA Fund is a fund of The Kentucky Bar Foundation, Inc., a nonprofit 501(c)(3) organization well known as the charitable arm of the Kentucky Bar.

Before the establishment of the IOLTA program, pooled client trust accounts in which the funds of multiple clients are deposited were required to be non-interest-bearing. This was the rule because lawyers are not allowed to earn interest on client funds and it was not practicable to pay numerous clients the minimal interest earned on their funds. The IOLTA program requires lawyers to convert non-interest-bearing pooled client trust accounts into IOLTA accounts with participating banks that agree to pay the earned interest to the IOLTA Fund. This program in effect uses the leverage of numerous pooled client trust accounts from across Kentucky to generate substantial income for the IOLTA Fund in excess of bank administrative fees for maintaining the accounts. Currently, there are approximately 2400 active IOLTA client trust accounts in the Commonwealth, and 120 participating banks.

The interest received by the IOLTA Fund is disbursed in the form of grants for legal aid to the poor, local bar *pro bono* programs, and projects to improve the administration of justice. Grant recommendations are prepared by the IOLTA Board of Trustees each year and submitted to the Kentucky Supreme Court for approval. While the makeup of grants varies from year to year, and there is no established percentage of funds for any specific program, in recent years a significant portion of the funds has supported the four regional legal services programs in the Commonwealth and the seven *pro bono* programs administered by local legal service providers and local bar associations. These programs directly support local lawyers who volunteer their time and talents to represent indigent clients. In addition, grants are made annually to the three Kentucky law schools for fellowships that allow law students to intern with law-related public service organizations at no cost to the organization. Remaining grants cover a wide range of administration of justice projects. Since 1988 over \$12.2 million has been awarded in grants by the IOLTA program.

A grant history and application form may be obtained by contacting the IOLTA Fund. Any nonprofit organization with a law-related project within the IOLTA Fund's mission is eligible to apply for a grant.

B. *IOLTA Is A Mandatory Program Effective January 1, 2010.* In September, 2009, the Supreme Court showed its continuing support of the IOLTA Fund by amending its Rule to require all pooled client trust accounts to be included in the program unless otherwise exempt. SCR 3.830 now provides that beginning January 1, 2010, all client trust accounts of KBA members must be IOLTA accounts unless an exemption applies under paragraph 14 of the Rule. Trust accounts in the name of a single client are not subject to IOLTA and continue to be maintained for the exclusive benefit of the client. Lawyers who are not in private practice or who do not hold clients' funds in trust are generally exempt from the rule.

C. *Opening an IOLTA Account.* An IOLTA account may be established with any bank or other financial institution, which meets certain criteria as set out in SCR 3.830:

- authorized to do business in Kentucky,
- insured by the Federal Deposit Insurance Corporation (FDIC), and
- has an agreement with the IOLTA Fund to participate.

To open an IOLTA account, the lawyer should first open a standard, non-interest-bearing client trust account. This account may then be added to the IOLTA program by submitting an *Authorization for Kentucky IOLTA Account* form to the IOLTA Fund. A copy of the authorization form is at Appendix E. The Fund will then enter the account into its records and forward the authorization form to the bank concerned. The bank will then convert the account to interest-bearing and assign the Kentucky Bar Foundation's tax identification number to the account to assure that the interest is properly reported as being paid to the IOLTA Fund, a nonprofit organization. The bank will change the account name to "Kentucky Bar Foundation IOLTA Trust Account for [name of lawyer or firm]." This is necessary to prevent the Internal Revenue Service from issuing a "B" notice to the lawyer because the named holder of the account and the tax identification number of the account do not match.

VII. INTEREST ON LAWYERS' TRUST ACCOUNTS FUND (IOLTA)

This account name change does not limit a lawyer's flexibility in choosing the name to be printed on checks and deposit slips.

Since the IOLTA Fund is the beneficial holder of the interest, IOLTA client trust accounts qualify for interest-bearing accounts that are open to individual attorneys and law firms regardless of whether the firm is a partnership, limited liability company, or professional service corporation.

D. Bank Charges. Enrolling a client trust account in the IOLTA program does not result in additional bank service charges for lawyers because the IOLTA Fund pays any reasonable bank charges or service fees associated with the account's interest-bearing status. Lawyers remain responsible for all other fees such as check printing charges, wire transfer fees, and overdraft fees.

E. Availability of Funds Deposited in an IOLTA Account. The IOLTA Rule requires that funds in IOLTA client trust accounts be subject to withdrawal upon request and without delay — a requirement that parallels the professional responsibility requirement that funds the client is entitled to receive be promptly disbursed.

F. Unauthorized Deposits to an IOLTA Account. No funds may be deposited in any IOLTA account when either the amount or the period of time that the funds are held would earn for the client interest above the costs that would otherwise be incurred to generate such interest. It is a lawyer's fiduciary duty to deposit client funds in an interest-bearing dedicated client trust account for the benefit of the client if the amount or time that funds will be held justifies the associated costs of a separate account.

G. Changes to Accounts. Lawyers are required to keep the IOLTA Fund informed of any changes to their IOLTA accounts or their law firm affiliation. A certificate of compliance with the IOLTA Rule is periodically included with the annual KBA dues statement. The certificate requires KBA members to certify that the information on the statement is correct or to provide any changes to the IOLTA Fund.

H. Bank Participation. A vital component to the success of Kentucky's IOLTA Fund is the involvement of banks throughout the Commonwealth. Banks voluntarily enroll in the program. Many banks help even more by not charging service fees on IOLTA accounts.

I. Confidentiality. The IOLTA Fund may recognize those lawyers and firms that participate in the Fund and their dates of participation. Any other information the Fund receives regarding IOLTA accounts is confidential and is available only to IOLTA staff and Trustees. The IOLTA Fund does not receive copies of bank statements or other notices on client trust accounts. SCR 3.830 specifically provides for the information that is to be provided by the banks to the IOLTA Fund.

J. IOLTA Board of Trustees. The IOLTA Fund is administered by a Board of Trustees. Members of the Board are appointed by the KBA Board of Governors and approved by the Kentucky Supreme Court. Each of the seven Supreme Court Districts is represented on the Board. In addition, the Chief Justice of the Supreme Court of Kentucky, the President of the Kentucky Bar Association, and the President of the Kentucky Bar Foundation Board of Directors, or their designees, serve on the Board. A member of the banking community also serves on the Board.

K. IOLTA Fund Staff. The IOLTA Fund is managed by Executive Director Todd S. Horstmeyer and Program Manager Gwen McCall.

L. Additional Information. Further information concerning the Kentucky IOLTA Fund can be obtained from the IOLTA office located at the Kentucky Bar Center, 514 West Main Street, Frankfort, Kentucky 40601-1812, or by calling 1-800-874-6582.

APPENDIX A

LIST OF REFERENCES AND SOURCES

1. Kentucky Rules of Court — State (2008).
2. Selected Kentucky Revised Statutes.
3. Selected Kentucky Supreme Court Decisions.
4. ABA/BNA *Lawyers' Manual on Professional Conduct*.
5. ABA *Annotated Model Rules of Professional Conduct, Sixth Edition* (2007).
6. *Kentucky Legal Ethics Opinions and Professional Responsibility Handbook*, 3rd ed. (2004).
7. Wolfram, *Modern Legal Ethics* (1986).
8. American Law Institute, *Restatement of The Law Third, The Law Governing Lawyers* (2000).
9. *The ABA Guide to Lawyer Trust Accounts*, Jay G. Foonberg (1996).
10. State Bar of California, *Handbook on Client Trust Accounting for California Attorneys* (2003).
11. North Carolina State Bar, *The North Carolina State Bar Attorney's Trust Account Handbook* (2003).
12. New York Lawyers' Fund for Client Protection brochure: *A Practical Guide to Attorney Trust Accounts and Recordkeeping* (1999).
13. *In the Client's Trust: A Guidebook on Trust Accounts for Kentucky Lawyers*, sponsored by the Kentucky IOLTA Fund and Lawyers Mutual Insurance Company of Kentucky.
14. Virginia CLE Publications: *Lawyers And Other People's Money*, 3rd ed. (2000), by Frank A. Thomas III.

APPENDIX B

Selected KBA Ethics Committee Opinions

1. Interest — *Lawyers may not earn interest on client trust accounts.*

KBA E-126 (1975)

Question: A law firm maintains an escrow account in which funds belonging to clients and others are deposited and from which funds belonging to clients and others are disbursed. There are many transactions in and out of this account. May the firm invest part of the balance in federally insured deposits and use the interest to help pay the expense of the accounting for the escrow account?

Answer: No.

OPINION

The firm proposes to invest the excess cash in a time certificate. Cash overdrafts on the escrow account may result from temporary unavailability of escrow cash. The firm's bank will honor such overdrafts and charge them to the firm's master note secured by assignment of the time certificate. Interest on the certificate would be paid to the firm. The firm would pay the interest on the aforementioned overdrafts.

The money in the escrow account does not belong to the several persons having an interest in the account. The law firm's contention is that since the interest would be used to account for the escrow funds, the persons having interest in the escrow account would indeed have the benefit of the interest. The law firm has the obligation to account for the escrow funds. It is clear to us that it is the law firm, and not the owners of the escrow funds, who would benefit from the interest.

2. Deposits — *Credit card payments by clients.*

KBA E-172 (1977)

Question: May a law firm accept major credit cards as a method of payment for legal services performed by that firm?

Answer: Yes.

Reference: ABA Formal Opinion 338 (1974)

OPINION

A lawyer may participate as a payee in a credit card plan provided:

- (1) All publicity and advertising relating to the plan has been approved in writing by the Kentucky Bar Association;
- (2) No publication of any kind is made of the names of lawyers or law firms who subscribed to the plan;
- (3) The lawyer does nothing to promote use of the plan except a discrete indication in his office that payment through the plan is acceptable; and
- (4) The lawyer makes no agreement that obliges him or may oblige him to violate any rule of legal ethics. E.g., he could not agree to supply credit information concerning his clients and he could not make an unqualified agreement to permit inspection of his books and records.

3. Deposits — *Credit card payments by clients.*

KBA E-426 (2007)

Subject: The use of credit cards (Fn.1) for payment of earned attorney fees, non-refundable retainers, and advances.

Question I: May a lawyer accept credit card payment for both earned fees and non-refundable retainers? If so, must the payment be deposited in the lawyer's office account?

Answer: Yes

Question II: May a lawyer accept credit card payment for advances on either attorney fees or costs and expenses? If so, where must the lawyer deposit the funds?

Answer: See discussion below.

Question III: May the lawyer pass the credit card service charges on to the client?

Answer: See discussion below.

References: KBA E-172 (1977); ABA Formal Op. 338(1974); KBA E-380 (1995); Kentucky Bar Ass'n v. Bubbenzer, 145 S.W.3d 842 (Ky. 2004); Clendenin v. Kentucky Bar Ass'n, 114 S.W.3d 858 (Ky. 2003);

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SCR 3.130 (1.4); (1.5), (1.15), (1.16) and (7.05); Geoffrey C. Hazard, Jr., and W. William Hodes, *The Law of Lawyering*, sec. 19.4 (2002 Supplement); Or. Eth. Op.2003- 172, WL 22397286 (2003); N.C. Bar Op. 247 (1997); S.C.Op. 98-08 (1998).

OPINION

Introduction

In 1977, this Committee issued KBA E-172 authorizing Kentucky lawyers to accept credit cards in payment of legal services. The opinion affirmed the position of the ABA, as reflected in Formal Opinion 338 (1974). (Fn. 2) These older opinions assumed that the credit card payments were for services that had already been performed by the lawyer. Today's questions involve an extension of earlier practices and ask whether credit cards may be used to pay non-refundable retainers and advances on fees and expenses that have not been earned or incurred by the lawyer. In addition, there are issues as to what type of account credit card payments are to be deposited in and whether the lawyer can charge the client for bank service charges incurred in connection with the use of a credit card.

It should be noted that many of these issues are not unique to credit card transactions and may be equally relevant when payments are made by check or other electric transfer. Nevertheless, consumers, including consumers of professional services, increasingly rely upon the use of credit cards to pay for those services. The purpose of this opinion is to address some of the general ethical issues that may arise in conjunction with the use of credit cards. It is not the objective of this opinion to discuss the intricacies of the lawyer's contract with the credit card company, nor to dictate the precise details of how those arrangements should be structured.

I. Credit Card Payment for Earned Attorney Fees and Non-refundable Retainers

KBA E-172 (1977) states that a lawyer may accept credit cards as a method of payment for services that have been performed — earned fees. Once a lawyer has earned a fee, he or she is entitled to payment. If a credit card is used to pay the fee, the funds belong to the lawyer and should be deposited to the lawyer's office account.

On the issue of non-refundable retainers, KBA E-380 (1995), provides that a lawyer may charge a client a reasonable "non-refundable" retainer in order to secure the lawyer's services. In that opinion, the Committee noted that the term "retainer" has come to have several meanings and it emphasized that it was talking about the "true" retainer to secure the lawyer's services, not an "advance" on fees and expenses. The opinion states that a true retainer can only be designated "non-refundable" if the lawyer complies with the detailed requirements set forth in the opinion. (Fn. 3) KBA E-380 further states that "the lawyer who receives a retainer has earned the fee by promising to be available for future work, and the funds so received need not be put in a trust account." This is true despite the fact that the opinion recognizes that there may be cases where the lawyer may be obligated to return "some portion of the 'non-refundable' fee retainer upon termination of the representation, depending upon all the circumstances; that is, the 'reasonableness' of the fee."

The Committee is unaware of any rule of professional conduct that would prohibit the use of a credit card for the payment of a non-refundable retainer and, like the earned fee, the funds should be deposited in the lawyer's office account. See SCR 3.130 (1.15) prohibiting the commingling of lawyer and client funds.

II. Credit Card Payment for Advances on Attorney Fees, Costs and Expenses

In some areas of practice, it is common for a lawyer to require a client to pay an "advance," before the lawyer commences work on the client's behalf. An advance serves as a fund from which the lawyer may withdraw fees as they are earned, and costs and expenses as incurred. Although there is nothing ethically impermissible about requiring such an advance, the lawyer must comply with the applicable rules of professional conduct. Specifically, the lawyer must have a clear understanding with the client about the purpose of the advance and may withdraw funds only upon proper authorization. These obligations arise from the duty to communicate with the client under SCR 3.130(1.4), the duty to protect and account for client property under SCR 3.130(1.15), as well as the lawyer's duties upon termination of the representation under SCR 3.130(1.16(d)).

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Question II asks whether a lawyer may accept credit card payment for advances. As previously noted, KBA E-172 only addressed the use of credit cards in conjunction with “legal services performed” — earned fees — and it did not consider the use of credit cards for advances to cover unearned fees and expenses.

The Committee is of the view that there is nothing inherently unethical about charging an advance to a credit card, as long as the advance meets the requirements of reasonableness imposed by Rule 1.5 and the lawyer complies with the rules on handling client property contained in Rule 1.15. Unlike earned fees and non-refundable retainers described in Questions I, advances serve as security for future charges and, until earned, the funds belong to the client. As a result, the lawyer has a special responsibility to safeguard advances. The lawyer’s fiduciary responsibilities are outlined in SCR 3.130(1.15), and include the duty to segregate client funds in a trust account and to keep complete records. *See generally*, Geoffrey C. Hazard, Jr., and W. William Hodes, *The Law of Lawyering*, sec. 19.4 (2002 Supplement).

The duty to segregate client funds has a number of implications for lawyers who accept credit cards. As noted above, credit card proceeds for advances must be deposited in a trust account. There are number of ways in which a lawyer might deal with his or her “merchant account.” (Fn.4) One solution is for the lawyer to have two merchant accounts, one would be a business account and the other would be a trust account. The lawyer would have to exercise care to distinguish between various types of charges so that funds were credited to the proper account. *See Or. Eth. Op.2003-172, WL 22397286* (2003). The other alternative is to establish a trust account into which all credit card funds flow and if some portion of the deposited funds belongs to the lawyer, it should be withdrawn. *See Or.Eth. Op., supra*, (stating that if the bank insists on a single account, it should be a trust account) and N.C. Bar Op. 247 (1997) (stating that if the bank will only deposit funds into a single account, all payments should be deposited into a trust account and funds belonging to the lawyer should be withdrawn). The current rules recognize that there are some occasions where the lawyer’s trust account will, for a period, contain funds belonging to both the lawyer and the client. This may be unavoidable, as

where settlement check is issued in a contingent fee case. In any case, where the lawyer has a right to funds in the trust account, it is critical that the lawyer maintain accurate records, monitor the account scrupulously, and comply with the applicable requirements of SCR 3.130(1.15).

The more difficult issue relates to what are known as a “charge-back.” If credit card proceeds are deposited in a trust account and the client disputes the charge, the disputed amount will be charged back — withdrawn from the trust account. If the lawyer has disbursed the credit card proceeds prior to the charge-back, then the charge-back will be against other clients’ funds. The same is true with a check that is dishonored. Any arrangement that compromises the integrity of the trust account violates SCR 3.130(1.15). A lawyer could avoid the ethical implications of a charge-back by delaying disbursements until after the time a charge-back could occur. Alternatively, the lawyer might negotiate an agreement with the bank whereby any charge-back would be made against the lawyer’s business account, rather than the trust account to which the funds were deposited. It is not the function of the Committee to explore all of the options that might be available for avoiding charge-backs against trust accounts. We merely caution lawyers that any arrangement that could result in charge-back against another client’s funds in a trust account is strictly prohibited.

III. Service Charges

Like a merchant who accepts credit cards in payment of goods, a lawyer who accepts credit cards will be charged a transactional fee by the financial institution processing the charge. The question is whether the lawyer can pass these transactional costs on to the client, assuming that such a practice does not violate the contract with the financial institution or any other law. A number of ethics committees in other jurisdictions have considered this issue and concluded that lawyers may pass reasonable transactional costs of credit card use on to clients if the client agrees to such a charge. *See, e.g., Or. Eth. Op. 2003-172; N.C. Bar Op. 247; S.C.Op. 98-08* (1998). SCR 3.130(1.5) provides that “the basis or rate of the fee should be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation.” Because the

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practice of passing service charges on to the client deviates so dramatically from the commonly accepted practice in the commercial world, lawyers have an unusually high burden in making sure the client fully understands the consequences of electing to use a credit card. The client must be advised that he or she will be responsible for an amount in excess of the billed charge if a credit card is used and what the additional charge will be, as well as any other information that may be necessary to adequately inform the client of the nature of the payment arrangement. (Fn. 5) Moreover, although the current rules do not require that such communications be in writing, it is the Committee's view that, especially where an additional charge is added for credit card use, both clients and lawyers will be best served if the agreement is in writing.

Conclusion

Consumers rely heavily upon the use of credit cards and other forms of electronic payment and the Kentucky Rules of Professional Conduct authorize lawyers to accept credit cards for the payment of fees. See SCR 3.130(7.05) and KBA E-172 (1977). As the use of credit cards and other forms of electronic payment become more common, lawyers will need to be increasing cautious in structuring these arrangements to ensure compliance with all of their ethical obligations, particularly those relating to client communication, segregation of client funds and accounting.

Fn. 1: Although this opinion focuses on the use of credit cards, many of the same principles apply to debit cards and other electronic transactions.

Fn. 2: Both KBA E-172 (1977) and ABA Formal Opinion 338 (1974) expressed various concerns about improper advertising and solicitation under the rules that were in effect at that time. In 2000, the ABA withdrew Formal Opinion 338, and three other opinions relating to the use of credit cards, because the adoption of the ABA Model Rules of Professional Conduct rendered the guidelines relative to advertising and solicitation contained in those opinions inapplicable. ABA Formal Op. 00-419 (2000).

Fn. 3: KBA E-380 (1995) provides as follows:

Accordingly, we find that in order for a non-refundable fee retainer to be valid the arrangement must meet the following criteria:

1. The arrangement must be fully explained to the client, orally, and in a written fee agreement that is signed by the client;
2. The arrangement must specify the dollar amount of the retainer, and its application of the scope of the representation, and/or the time frame in which the agreement will exist; and
3. The total fee to be charged must be "reasonable."

A "retainer" that does not meet these requirements will be treated as an advance and must be deposited in the client trust account. In the event the lawyer is terminated, the unearned portion of the advance must be returned to the client. See, *Kentucky Bar Ass'n v. Bubenzer*, 145 S.W.3d 842 (Ky. 2004); *Clendenin v. Kentucky Bar Ass'n*, 114 S.W.3d 858 (Ky. 2003).

Fn. 4: As used here, the term "merchant account" is the account in which the credit card proceeds are de-positied.

Fn. 5: If the client is entitled to a refund, it should be processed in such a way so as to return the applicable transactional fee charged, if any.

4. Disbursements — *Collecting fees for one matter by offset from client funds held on an unrelated matter not allowed.*

KBA E-233 (1980)

Question: May an attorney offset, against some judgment due his/her client from one cause of action, an amount due the lawyer on a previous unrelated case?

Answer: Qualified yes.

References: DR 9-102(A)(B); *In re Geraldts*, 263 N.W. 2d 241 (Mich. 1978); *Florida Bar v. Sawyer*, 334 So.2d 259 (Fla. 1976); *Greenbaum v. State Bar*, 15 Cal.3d 893 (Cal.1976); *In re Marine*, 264 N.W.2d 285 (Wisc. 1978); ABA Informal Opinion 1375, 1376.

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OPINION

DR 9-102(A)(2) of the Code of Professional Responsibility permits an attorney to withdraw from the client's funds any sum owing to the lawyer or the law firm when it is due unless there is a dispute over the amount due. The Ethics Committee is not authorized to answer questions of law. Therefore, we cannot consider whether an attorney may have a lien on these funds.

A number of jurisdictions have considered this question from a legal as well as an ethical viewpoint. Most states will say that the lawyer must at least give some notice to the client as to the imminent withdrawal of funds *See In re Gerald*, 263 N.W.2d 241 (Mich. 1978); *Florida Bar v. Sawyer*, 334 So.2d 259 (Fla. 1976); *Greenbaum v. State Bar*, 15 Cal.3d 893 (Cal. 1976).

One court has found that the attorney and the client must reach an explicit agreement about the attorney's right to withdraw clients' funds "when due." For the attorney to withdraw funds from the client's trust account, even "when due" the attorney and client must at least agree on three points:

- (1) the right of the attorney to expect the client to pay a specific claimed fee,
- (2) the amount to which the attorney is entitled,
- (3) the time at which payment is expected.

The court further held in absence of an agreement with the client on these matters, a reasonably prudent attorney should not assume that he may withdraw funds pursuant to DR9-102(A)(2). *In re Marine*, 264 N.W. 2d 285 (Wisc 1978).

DR 9-102(B)(4) requires that the attorney promptly pay or deliver to the client upon request any funds, securities or other properties which the client is entitled to receive (emphasis added). In ABA Informal Opinion 1375 and 1376 the American Bar Association Ethics Committee suggested that when there is a conflict between an attorney and client about who is entitled to funds in an attorney's possession and when this conflict is not quickly and amicably resolved, an attorney may properly file an action for the adjudication of the rights of all claimants. The respective interests of the lawyer and client can be protected by court order in an adversary proceeding or by private agreement of the parties.

The Committee feels that an attorney may very well enter into a *written* contract with the client at the time of employment allowing the lawyer to offset all lawyer's fees on any judgment(s) or (settlement(s)) in the future (assuming full disclosure). However, in absence of a written contract of employment it is our opinion that the lawyer may not withdraw amounts due the lawyer for an unrelated cause of action. We feel any fee not paid promptly by the client is in dispute within the meaning of DR 9-102(A)(2).

A lawyer should be zealous at the time of closing out the one case not to withdraw the funds at that time. Although, with a contract executed at that time and after full disclosure the lawyer could issue another check to the lawyer in payment of these fees.

In the absence of the above the lawyer must remit to the client the funds the client is entitled to or resort to a legal remedy of which this Committee has no jurisdiction.

5. Disbursements — Refusing to return client files because of a fee dispute.

KBA E-395 (1997)

Question: May a lawyer hold a client's file because of a fee dispute?

Answer: Qualified No.

References: KRPC 1.16(d); KBA E-280 (1984) and E-235 (1980); ABA Annotated Model Rules of Professional Conduct (3d Ed. 1995) pp. 257-58.

OPINION

KRPC 1.16(d) provides that "upon termination of representation" a lawyer shall "take steps to the extent reasonably practicable to protect a client's singular interest ... surrendering papers and property to which the client is entitled..." Comment (10) to KRPC 1.16(d) states that "[t]he lawyer may retain papers as security for a fee only to the extent permitted by law." Whether a lien is permitted by law is a question of law. In Kentucky, a charging lien on the funds or property recovered in a lawsuit is authorized by statute law, but the Committee is not aware of any statute or case that provides a Kentucky lawyer with a retaining lien.

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A number of newer state bar opinions state that even if the assertion of a retaining lien is legal, there may be ethical limits on its exercise. See ABA Annotated Model Rules, pp. 257-58. See also Fortune, Underwood & Imwinkelried, *Modern Litigation and Professional Responsibility Handbook* (1996).

In KBA E-235 the Committee answered with a qualified “yes” to the question, “[when] a lawyer has been discharged by a client may he refuse to deliver certain items in the file to the client?” The Committee cited with approval ABA Formal Opinion 1376, which set forth specific materials that had to be returned to the client in a trademark case:

- A. Notes and memos to the file prepared by the attorney containing recitals of facts, conclusions, recommendations;
- B. Correspondence between attorney and client;
- C. Correspondence between attorney and third party;
- D. Material furnished by the client ...;
- E. Application, receipts, affidavits filed, in respect to use, etc. ...;
- F. Searches made at the expense of the client;
- G. Copies of the pleadings and the like filed in an administrative or court proceeding; and
- H. Legal research embodied in the memos or briefs.

However, the above opinion was predicated on the assumption that the lawyer’s fee had been paid.

KBA E-280 extended the above opinion by answering a “qualified yes” to the questions, “[may] a lawyer charge a fee for duplication of the client’s file after the lawyer has been discharged?” The Committee determined “that a discharged lawyer may charge his former client for the actual costs involved in the duplication of a file, provided the lawyer does not charge a fee disproportionate to the actual costs of such duplication.” The Committee added, however, that the lawyer may withhold materials within the lawyer’s “work product privilege” from the client in the event of discharge.

Together these opinions, along with KRPC 1.16(d), make it clear that the lawyer must turn over the file to the client or the client’s attorney except for “work product.” Documents or other relevant

evidence, the original of which may be required for trial preparation or as evidence for trial, must be surrendered in the original form.

The lawyer does not have a statutory lien for the costs of duplication, but the lawyer is permitted to charge for the reasonable costs of duplication. Under no circumstances may the lawyer hold hostage the file. While the lawyer is entitled to reimbursement for costs incurred “including filing fees, service fees and costs for obtaining medical records,” the lawyer should “surrender” the file even if reimbursement is not forthcoming.

6. Disbursements — Upon the death of a “Sole Practitioner.”

KBA E-405 (1998)

A “sole practitioner” - for purposes of this opinion, a lawyer who has no law partners or persons with similar rights and powers - dies. A “sole practitioner” employed associates or salaried lawyers who have no proprietary interest in the business of the deceased lawyer’s firm, no or extremely limited managerial responsibilities, and no or very limited rights in the attorney-client fee contracts and files. Upon the death of the “sole practitioner,” the formerly employed lawyers find themselves unemployed, unpaid, and technically unable to act as agents for the deceased lawyer, the “firm,” or the estate. What ethical duties do these lawyers owe to clients with whom they dealt personally and to courts in which they are appearing on behalf of clients of the “firm”?

Answer: See Opinion.

References: KRPC 1.1, 1.3, 1.15; ABA Formal Op. 92-369 (1992); Del O’Roark, *Post Mortem Professional Responsibility*, 57 *Bench & Bar* 2, Spring 1993 (pg.41).

OPINION

This question has come up several times in recent months. Of course, a law partner in a partnership would have the ability and authority to pick up the pieces. In the absence of a law partner, it is assumed that the deceased lawyer’s personal representative would step into the deceased lawyer’s shoes, not for the purpose of practicing law, but for the purpose

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of notifying clients, arranging for the disposition of files, and winding up the deceased lawyer's affairs. See SCR 3.395. While SCR 3.395 provides for the appointment of a Special Commissioner to protect client interests in limited circumstances, the KBA will understandably be reluctant to assume the burdens and expenses associated with SCR 3.395 if there is a surviving partner or a personal representative available to do the winding up.

To fulfill his or her obligation to protect client files and property, a sole practitioner should prepare a future plan providing for the maintenance and protection of client interests in the event of the lawyer's death. Such a plan should, at a minimum, include the designation of another lawyer who would have the authority to review client files and make determinations as to which files need immediate attention, and who would notify the clients of their lawyer's death. For further guidance see *ABA Formal Op. 92-369 (1992)*.

Unfortunately not all sole practitioners will have made such plans. If the lawyers left behind were employees with no proprietary interest in the firm, it may be possible for them to protect the interests of all of the sole practitioner's clients, and we encourage them to attempt to do this. However, this would require the timely cooperation and support of the deceased lawyer's personal representative. The now unemployed lawyers should not be expected to work for the benefit of the estate or the deceased sole practitioner without compensation. Furthermore, the lawyers may have no knowledge of matters involving clients whom they have not personally served, may have no access to client files, and may have no authority to write checks or deal with accounts of the decedent.

The Committee is of the opinion that the formerly employed lawyers continue to have the limited obligations set forth in the KRPC - e.g., KRPC 1.1, 1.3, 1.4, and 1.15 - e.g., to notify clients for whom they have been providing services, so that those clients may provide them with instructions that will protect the clients' interests, and move to withdraw from representation in any matter pending before a tribunal if the lawyer is no longer authorized to act for the client. Obviously, those clients may obtain other counsel or employ the lawyer contacting them, subject to any interest of the estate arising from any preexisting contract. These contacts are

not prohibited solicitation given the lawyer's prior professional relationship with the client.

However, in matters where there exists no attorney-client relationship between the associated lawyers and the client, the associated lawyers have no obligation to the clients or the estate of the responsible attorney to provide continuing professional services.

7. Disbursement Disputes — *Third party claim on funds and a lawyer's obligation to pay service providers.*

KBA E-383 (1995)

Question 1: Does a lawyer have an ethical obligation to ensure payment to an individual who has provided services to, or on behalf of the lawyer's client, or in the furtherance of the client's case:

- a) if the lawyer hired the individual provider?
- b) if the lawyer did not hire the individual provider?
- c) if, under the same circumstances as 1(a) and 1(b) above, no recovery is had, or the recovery is insufficient?
- d) if the client directs the lawyer not to pay the third person, and instead directs the lawyer to deliver all funds or property to the client?

Question 2: Do the Rules of Professional Conduct require a lawyer to recognize and comply with a third person's claim of ownership to the client's property that is in the lawyer's possession?

Answers: 1(a). Yes. 1(b), 1(c), 1(d), and 2. See Opinion.

References: KBA E-297; *Leon v. Martinez*, 614 N.Y.S.2d 972 (N.Y. 1994); Rule(s) 1.2(d) & (e), 1.15(b) and 4.1; *Unigard Ins. Co. v. Tremont*, 430 A.2d 30 (Conn. 1981); KBA/KMA Interprofessional Code, Minnesota Op. 7 (1983). Dist. of Col. Op. 251 (1995).

OPINION

The inquiry presents mixed questions of law and ethics and this committee is limited to responding based upon matters of ethics. See KBA E-297.

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Regarding Question 1(a):

An attorney has an ethical as well as a legal obligation to ensure payment to a third party employed by the attorney to provide services in furtherance of the client's claim where there is no valid dispute that the services were performed in accordance with the employment.

Under certain circumstances an attorney is required by the applicable law of the case to ensure payment to a third party. See Rule 1.15(b); Interprofessional Code, para VI and VII. Reference is also made to Minnesota Op. 7 (1983), which provides:

Opinion 7 Costs of Litigation; Fees.

An attorney may not deny responsibility for the compensation of services rendered by doctors, engineers, accountants, attorneys or other persons, when the attorney requested the services without explicitly stating that the provider should not look to the attorney for payment. Lawyers should expressly disclaim liability in writing at the time the services are requested. A lawyer ordering services is liable as a principal for those services absent an express disclaimer. A lawyer may not, by deceitful or fraudulent means, seek to avoid financial obligations. DRs 102 (A) (4) (5). 7-101(A)(1)(2)(7). (Adopted 1/26/74, amended 10/26/79, repealed 1/7/83).

In those situations where the attorney ordered the performance of services for the client, participated in obtaining services for the benefit of the client, obtained services for the benefit of the client without making it clear to the provider of such services that the provider should look solely to the client, or where the lawyer conferred with a third party, with the client's knowledge, to take no present action against the client, for example, a third person's pursuing a collection action against the client until the settlement of the client's claims which is the basis of the lawyer's representation of the client, the lawyer has an obligation under the Rules of Professional Conduct to ensure payment of those services. However, absent these circumstances, an attorney is under no ethical obligation to assume the role of an insurer of third party claims. When an attorney accepts such a role at the direction of the attorney's client or where such a role is imposed on an attorney as a result of representing the client, then the

attorney is bound by the Rules of Professional Conduct to fulfill the responsibility as part of the lawyer's duty to the client.

Regarding Question 1(b):

See above.

Regarding Question 1(c):

See above.

Regarding Question 1(d):

If an attorney is under a duty imposed by law, then the attorney is required to comply with the law. Where prior actions of the client or the circumstances of the representation place the attorney in the position of a surety, then the attorney's conduct must comply with the law of surety. If a dispute should arise between the client and the third party, concerning a properly asserted claim, then the attorney should protect the funds and property until the dispute is settled or until ordered to distribute the funds or property. See *Leon v. Martinez* (citing DR 9-102, the predecessor to Rule 1.15(b)); *Unigard Ins. Co. v. Tremont* (lawyer who ignored insurer's statutory lien committed conversion); Rule(s) 1.2(d) & (e) and Rule 4.1.

In this regard the following Comments to Rule 1.15 provide guidance that has applicability here.

(2) Lawyers often receive funds from third parties from which the lawyer's fee will be paid. If there is risk that the client may divert the funds without paying the fee, the lawyer is not required to remit the portion from which the fee is to be paid. However, a lawyer may not hold funds to coerce a client into accepting the lawyer's contention. The disputed portion of the funds should be kept in trust and the lawyer should suggest means for prompt resolution of the dispute, such as arbitration. . . .

(3) 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.

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Regarding Question 2:

In the circumstances stated above, an attorney may refuse to surrender the property to the client, but the attorney is not under an ethical obligation, under the Rules of Professional Conduct, to protect the interests of third parties. See comments at page 262 of the American Bar Association's text, *Annotated Model Rules of Professional Conduct*, Second Edition (1992).

8. Disbursement Disputes — Client objects to fees and expenses charged.

KBA E-292 (1985)

Question: May an attorney withdraw from funds received from third parties an amount due the lawyer for fees and expenses, when such fees are in dispute, and the client does not agree to such withdrawals?

Answer: No.

References: DR 9-102(A)(2); KBA E-233; Legal Background to the ABA Model Rules of Professional Conduct; Comment (2) to Model Rule 1.15.

OPINION

A complex factual situation should be summarized briefly before we address the ethical considerations involved.

A client retained a firm under an oral agreement providing for a flat fee for up to six hours time expended on her behalf, and then at a certain hourly rate after the first six hours. The client sought dissolution of her marriage from her husband, whom she had previously divorced and remarried. She also sought custody of her minor child. The client also sought the firm's services in obtaining property left to her minor child (the natural child of her current husband) from an Indiana testator. During the course of representation of the client on these matters, the firm also represented her in a criminal case.

After much effort, it was determined that an HHH Savings Bond of \$5000 was available for the minor child from the above mentioned estate. This bond had been mistakenly delivered to the client's husband. Necessary steps to recover the bond and have the client named as guardian for the purposes of handling the funds generated from the bond were made.

Finally, a separation agreement was affected which contained provisions relating to a garnishment in favor of the wife as well a trust agreement relating to the proceeds of the bond. During the course of the representation, the firm provided the client with detailed statements of charges for services rendered. Her account is now substantially in arrears. It has been learned that the attorneys in her original divorce action have never been paid.

The client demanded that all funds including the proceeds of the bond recovered for the benefit of her minor child be turned over to her, and that she be permitted to make monthly payments toward the fee. Sometime thereafter, the firm was discharged by the client.

When potential problems arose, all funds associated with this client were placed in a special escrow account. The question is if the funds in the special escrow account may be used to set off the entire fee as follows:

- (1) Since one-half the efforts were expended on behalf of the minor child, then a proportionate amount to be withdrawn from escrowed funds obtained on her behalf; and that
- (2) any escrow funds from the garnishment to be applied to the balance of the fee.

The ethical propriety of setting off sums owed for fees from client funds was addressed in KBA E-233 (1980). In that opinion, we referred to DR 9-102(2) which provides:

(A) All funds of clients paid to a lawyer or law firm, other than advances for costs and expenses, shall be deposited in one or more identifiable bank accounts maintained in the state in which the law office is situated and no funds belonging to the lawyer or law firm shall be deposited therein except as follows:

- (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.

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We also noted that “any fee not paid promptly by the client is in dispute within the meaning of DR 9-102(A)(2).” Because the Committee is not authorized to answer questions of law, we did not consider whether an attorney has a lien on such funds.

After reviewing pertinent authorities, we concluded that:

in the absence of an agreement with the client on these matters (the right of the attorney to a specific claimed fee, the amount to which the attorney is entitled, and the time at which payment is expected) a reasonably prudent attorney should not assume that he may withdraw funds pursuant to DR 9-102(A)(2).

We note that this position is reinforced by the following persuasive authorities: Proposed Final Draft, ABA Model Rules of Professional Conduct, Legal Background to MR 1.15(a) and (b); Legal Background to the ABA Model Rules of Professional Conduct, Tentative Draft (1984) (“Under both the Rules and the Code, disputed funds may not be withdrawn by the lawyer until the dispute is resolved. ABA Model Code DR 9-102(A)(2).”)

On the other hand, it is clear that it is proper to keep the disputed portion of the funds in a trust account until the dispute is settled. In that regard, Comment (2) to Model Rule 1.15, which is fully consistent with the Code and supporting case law, provides:

Lawyers often receive funds from third parties from which the lawyer’s fee will be paid. If there is a risk that the client may divert the funds without paying the fee, the lawyer is not required to remit the portion from which the fee is to be paid.... The disputed portion of the funds should be kept in trust and the lawyer should suggest means for prompt resolution of the dispute, such as arbitration. The undisputed portion of the funds should be promptly distributed.

See also, ABA/BNA Lawyer’s Manual on Professional Conduct 45:1104 (“...the attorney may keep a portion of the funds in a trust account until the dispute is settled”).

We also noted in KBA E-233 that counsel may resort to a legal remedy such as an action for the adjudication of the rights of all claimants, of which this Committee has no jurisdiction.

Finally, we also note that the propriety of any disbursements from the trust established in the separation agreement would present questions of law, of which this Committee has no jurisdiction.

APPENDIX C

ABA MODEL RULE ON FINANCIAL RECORDKEEPING

Preface

Rule 1.15 of the Model Rules of Professional Conduct, or its equivalent, requires that lawyers who are entrusted with the property of law clients and third persons in the practice of law must hold that property with the care required of a professional fiduciary. The basis for Rule 1.15 is the lawyer's fiduciary obligation to safeguard trust property, to segregate it from the lawyer's own property, and to avoid the appearance of impropriety.

Rule 1.15 specifically requires a lawyer to preserve "complete records" with respect to a law firm's trust accounts. It also obligates a lawyer to "promptly render a full accounting" for the receipt and distribution of trust property. A violation of Rule 1.15 may subject a lawyer to professional discipline. Rule 1.15 does not, however, provide lawyers or law firms with practical guidance in complying with these fiduciary obligations or in establishing basic accounting control systems for their law practices.

The Model Rule on Financial Recordkeeping is intended to give further definition to the requirements of Rule 1.15. Adapted from existing court rules, it proposes uniform and minimal standards for the maintenance of law firm financial records. These standards should guide lawyers and law firms, particularly those new to the practice of law.

1. A lawyer who practices in this jurisdiction shall maintain current financial records as provided in this 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.

2. 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.
1. 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.
2. Upon dissolution of any partnership of lawyers or of any legal professional corporation, the partners or shareholders shall make appropriate arrangements for the maintenance of the records specified in Paragraph A of this rule.
3. Upon the sale of a law practice, the seller shall make appropriate arrangements for the maintenance of the records specified in Paragraph A of this rule.

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SCR 3.830 KENTUCKY IOLTA FUND

The Kentucky Bar Foundation, Inc., a nonprofit corporation, shall maintain a special fund for the purpose of depositing interest from Kentucky Bar Association members' trust accounts, as hereinafter provided, and the name of the fund shall be the Kentucky IOLTA Fund ("IOLTA").

Except as set forth in paragraph (14) of this rule, a lawyer or law firm shall create and maintain in a participating financial institution, as defined in paragraph (4) below, an interest-bearing trust account for clients' funds which are nominal in amount or to be held for a short period of time so that they could not earn interest income for the client in excess of the costs incurred to secure such income (hereinafter sometimes referred to as an "IOLTA account") in compliance with the following provisions:

- (1) No funds may be deposited in any IOLTA account when either the amount or the period of time that the funds are held would earn for the client interest above the costs that would otherwise be incurred to generate such interest.
- (2) No earnings from an IOLTA account shall be made available to a lawyer or law firm.
- (3) An IOLTA account shall be established with a participating financial institution (i) authorized by federal or state law to do business in Kentucky, and (ii) insured by the Federal Deposit Insurance Corporation or its equivalent. Funds in each IOLTA account shall be subject to withdrawal upon request and without delay and without risk to principal by reason of said withdrawal.
- (4) Participating financial institutions that maintain IOLTA accounts shall pay on the accounts the highest interest rate or dividend generally available from the institution to its non-IOLTA account customers when IOLTA accounts meet or exceed the same minimum balance or other account eligibility qualifications. In determining the highest interest rate or dividend generally available from the institution, participating financial institutions may consider factors, in addition to the IOLTA account balance, that are customarily considered by the institution when setting interest rates or dividends for its non-IOLTA customers. Such factors should not discriminate between IOLTA accounts and accounts of non-IOLTA customers. All interest earned net of fees or charges shall be remitted to IOLTA, which is designated in paragraph (16) of this rule to organize and administer the IOLTA program, and the depository participating institution shall submit reports thereon as set forth below.
- (5) A participating financial institution may satisfy the comparability requirements set forth in paragraph (4) above by electing one of the following options: (i) Pay an amount on funds that would otherwise qualify for the investment options equal to 70% of the federal funds targeted rate as of the first business day of the month or other IOLTA remitting period, which is deemed to be already net of allowable reasonable service charges or fees. The foregoing option of paying 70% of the federal funds targeted rate shall only apply when such rate is established in the range of 1.0% to 4.0% unless otherwise agreed to by IOLTA and the participating financial institution. (ii) Pay a yield rate specified by IOLTA, if IOLTA so chooses, which is agreed to by the participating financial institution. The rate would be deemed to be already net of allowable reasonable fees and would be in effect for and remain unchanged during a period of no more than twelve months from the inception of the agreement between the financial institution and IOLTA.
- (6) IOLTA accounts may be established as:
 - (i) An interest-bearing checking account such as a negotiable order of withdrawal account;
 - (ii) a checking account with an automated investment feature, such as an overnight and investment in repurchase agreements or money market funds invested solely in or fully collateralized by U.S. Government Securities, including U.S. Treasury obligations and obligations issued or guaranteed as to principal and interest by the United States or any agency or instrument thereof;
 - (iii) a checking account paying preferred interest rates, such as money market or indexed rates;
 - (iv) any other suitable

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interest-bearing deposit account offered by the institution to its non-IOLTA customers.

(7) 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. 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, 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, the money market fund shall have total assets of at least two hundred fifty million dollars (\$250,000,000).

(A) Nothing in this rule shall preclude a participating financial institution from paying a higher interest or dividend than described above or electing to waive any service charges or fees on IOLTA accounts.

(B) Interest and dividends shall be calculated in accordance with the participating financial institution's standard practice for non-IOLTA customers.

(C) Allowable reasonable service charges or fees may be deducted from interest or dividends on an IOLTA account only at the rates and in accordance with the customary practices of the eligible institution for non-IOLTA customers. No fees or service charges other than allowable reasonable fees may be assessed against the accrued interest or dividends on an IOLTA account.

(D) Any IOLTA account which has or may have the net effect of costing IOLTA more in fees than earned in interest over a period of any time, may, at the discretion of IOLTA, be exempted from and removed from the IOLTA program. Exemption of an IOLTA account from the IOLTA program revokes the permission to use IOLTA's tax identification number for that account.

Exemption of such account from the IOLTA program shall not relieve the lawyer and/or law firm from the obligation to maintain the property of client funds separately, as required above, in a trust account and also will not relieve the lawyer of the annual IOLTA certification.

(8) Lawyers or law firms depositing client funds in an IOLTA account established pursuant to this rule shall, on forms approved by IOLTA, direct the depository institution:

(A) to remit all interest or dividends, net of reasonable service charges or fees, if any, on the average monthly balance in the account, or as otherwise computed in accordance with the institution's standard accounting practice, at least quarterly, solely to IOLTA. The depository institution may remit the interest or dividends on all of its IOLTA accounts in a lump sum; however, the depository institution must provide, for each individual IOLTA account, the information to the lawyer or law firm and to IOLTA required by subparagraphs (8)(B) and (8)(C) of this rule;

(B) to transmit with each remittance to IOLTA a statement showing the name of the lawyer or law firm for whom the remittance is sent, the rate of interest applied, average daily balance, service charges, if any, and such other information as is reasonably required by IOLTA;

(C) to transmit to the depositing lawyer or law firm a periodic account statement for the IOLTA account reflecting the amount of interest paid to IOLTA, the rate of interest applied, the average account balance for the period for which the interest was earned, and such other information as is reasonably required by IOLTA; and

(D) to waive any reasonable service charge that exceeds the interest earned on any IOLTA account during a reporting period ("excess charge").

(9) The IOLTA program will issue refunds when interest has been remitted in error, whether the

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error is the bank's or the lawyer's. Requests for refunds must be submitted in writing by the bank, the lawyer, or the law firm on a timely basis, accompanied by documentation that confirms the amount of interest paid to the IOLTA program. As needed for auditing purposes, the IOLTA program may request additional documentation to support the request. The refund will be remitted to the appropriate financial institution for transmittal at the lawyer's direction after appropriate accounting and reporting. In no event will the refund exceed the amount of interest actually received by the IOLTA program.

- (10) All interest transmitted to IOLTA shall be held, invested and distributed periodically in accordance with a plan of distribution which shall be prepared by IOLTA and approved at least annually by the Supreme Court of Kentucky, for the following purposes:
- (A) to pay or provide for all costs, expenses and fees associated with the administration of the IOLTA program;
 - (B) to establish appropriate reserves;
 - (C) to assist or help establish approved legal services and pro bono programs;
 - (D) for such other law-related programs for the benefit of the public as are specifically approved by the Supreme Court from time to time.
- (11) The information contained in the statements forwarded to IOLTA under paragraph (8)(B) of this rule shall remain confidential, and the provisions of any other Supreme Court Rules providing for confidentiality are not hereby abrogated; therefore, IOLTA shall not release any information contained in any such statement other than as a compilation of data from such statements, except as directed in writing by the Supreme Court.
- (12) IOLTA shall have full authority to and shall, from time to time, prepare and submit to the Supreme Court for approval, forms, procedures, instructions and guidelines necessary and appropriate to implement
- the provisions set forth in this rule and, after approval thereof by the Court, shall promulgate same.
- (13) On or before September 1 of each year, every lawyer admitted to practice in Kentucky shall certify to IOLTA, in such form as IOLTA shall provide ("IOLTA Certification Form"), that the member is in compliance with, or is exempt from, the provisions of this rule. The IOLTA Certification Form shall include the participating financial institution, account numbers, name of law firm or lawyer accounts and such other information as IOLTA shall require. If the lawyer is exempt from the IOLTA program, the lawyer must still submit an IOLTA Certification Form annually to certify to IOLTA that the lawyer is exempt from the provisions in this rule. Each lawyer shall keep and maintain records supporting the information submitted in the IOLTA Certification Form. The lawyer shall maintain these records for a period of three years from the end of the period for which the IOLTA Certification Form is filed, and these records shall be submitted to IOLTA upon written request.
- (14) The lawyer is exempt from this rule if:
- (A) not engaged in the private practice of law;
 - (B) does not have a trust account in a financial institution within the Commonwealth of Kentucky;
 - (C) serving full time as a judge, attorney general, public defender, U.S. attorney, commonwealth attorney, county attorney, on duty with the armed services or employed by a local, state or federal government, and is not otherwise engaged in the private practice of law;
 - (D) is a corporate counsel or teacher of law and is not otherwise engaged in the private practice of law;
 - (E) has been exempted by an order of general or special application of this Court which is cited in the certification;

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- (F) compliance with Rule 3.830 would work an undue hardship on the lawyer or would be extremely impractical, based on the geographic distance between the lawyer's principal office and the closest participating financial institution, or on other compelling and necessary factors; or
- (G) does not manage or handle client trust funds.
- (15) The determination of whether a client's funds are nominal or short-term so that they could not earn income in excess of costs shall rest in the sound judgment of the lawyer or law firm. No lawyer shall be charged with an ethical impropriety or other breach of professional conduct based on the good faith exercise of such judgment.
- (16) IOLTA is hereby designated as the entity to organize and administer the program established by this rule in accordance with the following provisions:
- (A) The determination of whether or not a financial institution is a participating institution as defined in paragraph (4) above, and whether it is meeting the requirements of this rule shall be made by IOLTA. IOLTA shall maintain a list of participating financial institutions, and shall provide a copy of the list to any Kentucky lawyer upon request.
- (B) Lawyers may only maintain IOLTA accounts in participating financial institutions. Participating financial institutions are those that voluntarily offer IOLTA accounts and comply with the requirements of this rule. If a financial institution becomes non-participatory, the lawyer or law firm must move its IOLTA account to a participating financial institution as described in paragraph (4) above, upon ninety (90) days written notice by IOLTA, and recertify to IOLTA the transfer.
- (17) If the IOLTA Certification Form is timely filed, indicating compliance, there will be no acknowledgment. Should an IOLTA Certification Form not be filed by a lawyer or if filed, fail to evidence compliance, IOLTA shall contact the lawyer and attempt to resolve the non-compliance administratively.
- (18) Lawyers licensed in Kentucky must notify IOLTA in writing within thirty (30) days of any change in IOLTA status, including the opening or closing of any IOLTA accounts, except as provided in paragraph (16)(B) above.
- (19) For the purpose of administering the funds deposited in the Kentucky IOLTA Fund, the Kentucky Bar Foundation is authorized to create a separate Board of Trustees to administer this fund, which shall consist of ten (10) members of the Association. One (1) member will be from each of the seven (7) Supreme Court Districts of the Commonwealth. The remaining three (3) members will be the Chief Justice of the Supreme Court of Kentucky, the President of the Kentucky Bar Association and the Chair of the Kentucky Bar Foundation, or a member of the Association appointed by each of such persons. These three (3) persons will serve year to year at the pleasure of the appointing person.
- (A) Members of the Board of Trustees from the Supreme Court Districts shall be appointed by the Board of Governors of the Kentucky Bar Association and approved by the Supreme Court. Appointments shall be made for a three-year term. Members may be reappointed, but no member shall serve more than two (2) successive three-year terms. Each member shall serve until a successor is appointed and qualified. Vacancies occurring through death, disability, inability, or disqualification to serve, or by resignation, shall be filled for the remainder of the vacant term in the same manner as the initial appointments are made by the Court. The members of the Board of Trustees of the Kentucky IOLTA Fund shall serve without compensation, but shall be paid their reasonable and necessary expenses incurred in the performance of their duties. The staff support for the Board of Trustees shall be paid by IOLTA.
- (B) The IOLTA Board of Trustees (the "Trustees") shall have general supervisory

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- authority over the administration of the IOLTA program, subject to the continuing jurisdiction of the Supreme Court.
- (C) The Trustees shall receive the net earnings from IOLTA accounts established in accordance with this rule and shall make appropriate temporary investments of IOLTA program funds pending disbursement of such funds.
- (D) The Trustees shall, by grants, appropriations and other appropriate measures, make disbursements from the IOLTA program funds, including current and accumulated net earnings, in accordance with the plan of distribution approved by the Supreme Court on at least an annual basis.
- (E) The Trustees shall maintain proper records of all IOLTA program receipts and disbursements, which records shall be audited or reviewed annually by a certified public accountant approved by the Supreme Court.
- (F) The Trustees shall be indemnified by IOLTA against any liability or expense arising directly or indirectly out of the good faith performance of their duties.
- (G) The Trustees shall present an annual administrative budget request to the Board of Governors for their approval, after which the budget shall be forwarded to the Supreme Court for approval. Staff for the operation of IOLTA shall be under the supervision and responsible to the Executive Director of the Bar Association.
- (H) The Trustees shall monitor attorney compliance with the provisions of this rule and will report to the Supreme Court those attorneys not in compliance.
- (I) In the event the IOLTA program or its administration by IOLTA is terminated, all assets of the IOLTA program, including any program funds then on hand, shall be transferred in accordance with the Order of the Supreme Court terminating the IOLTA program or its administration by IOLTA; provided, such transfer shall be to an entity which will not violate the requirements IOLTA must observe regarding transfer of its assets in order to retain its tax-exempt status under the Internal Revenue Code of 1986, as amended, or similar future provisions of law.

CLIENT TRUST ACCOUNT
Principles & Management
for Kentucky Lawyers

SECOND EDITION, 2010

APPENDIX E

(This form is also available for download on the KBA Website)



INTEREST ON LAWYERS' TRUST ACCOUNTS
Kentucky IOLTA Fund,
A Fund of The Kentucky Bar Foundation, Inc.

Authorization for Kentucky IOLTA Account

Firm Name

Address

Address

City, State & Zip Code

Telephone

Fax

E-Mail

I hereby authorize the financial institution(s) listed below to automatically and without further documentation convert the following trust account(s) to interest-bearing IOLTA account(s) in accordance with Kentucky Supreme Court Rule 3.830. I hereby assign all interest earned on such account(s) to the Kentucky IOLTA Fund and direct and authorize such financial institution(s) to remit the interest earned, less customary service fees or charges, if any, to the Kentucky IOLTA Fund. The Kentucky Bar Foundation, Inc. taxpayer identification number will be shown on the account as the recipient of the interest.

<u>Account Number</u>	<u>Account Name</u>	<u>Financial Institution</u>
_____	_____	_____
_____	_____	_____
_____	_____	_____

Each firm must attach a current listing of all attorneys who are associated with the firm.

Important Note

Effective January 1, 2010, the Kentucky Supreme Court Rule 3.830 requires every lawyer maintaining a pooled client trust account to offer such account for participation in the Interest On Lawyers' Trust Accounts (IOLTA) Fund unless otherwise exempt under the provisions of the Rule.

**Please return
this form to:**

Kentucky IOLTA Fund
Kentucky Bar Center
514 W. Main Street
Frankfort, KY 40601-1812

Firm: _____

KBA Attorney Signature

Date

**For additional information or assistance in completing this form,
contact the IOLTA office at 1-800-874-6582.**

CLIENT TRUST ACCOUNT

Principles & Management
for Kentucky Lawyers

SECOND EDITION, 2010



Lawyers Mutual
www.lmick.com

Lawyers Mutual Insurance Co. of Kentucky
Waterfront Plaza, 323 West Main Street, Suite 600
Louisville, KY 40202
502.568.6100 • 800.800.6101 (KY only)
502.568.6103 (FAX) • www.lmick.com



Kentucky IOLTA Fund
A Fund of the Kentucky Bar Foundation, Inc.
514 West Main Street, Frankfort, KY 40601-188
502.564.3795 • 800.874.6582 (KY only)
502.564.3225 (FAX) • www.kybar.org

Printed 2/2010