Avoiding Pitfalls in Trust Accounting

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We represent lawyers who are the subject of investigations or prosecutions by the Office of Lawyer Regulation (OLR). A clear focus of the OLR's attention, especially recently, is the mismanagement or lack of management of a lawyer's or firm's trust account. While the minutiae of trust account management and recordkeeping understandably feels like secondary busywork to many lawyers, it is the subject of detailed and particular Supreme Court Rules that are often difficult to understand.

Avoiding and addressing trust account problems begins at the start of representation, and can continue long after a matter is concluded. This presentation suggests ways to keep your trust accounting and funds management accurate and in compliance with Supreme Court Rules at all stages of representation.

1. Sound trust account management begins before representation starts.

Engagement Letters and Fee Agreement

Supreme Court Rule 20:1.5 requires written communication regarding fees in all but the narrowest of circumstances. Representation that is expected to cost more than $1,000 (including costs and fees), any matter handled on contingency, and any advanced fee deposited in a lawyer's operating account must be explained in writing, and contingent fee agreements must be signed by the client. It is a best practice to confirm all fees in writing even if the rule does not require it.

The engagement letter or agreement should clearly address how funds will be handled in connection with the trust account. For example, if advanced fees will be taken into trust and used to satisfy invoices as they are earned, this should be laid out, as should what will happen to funds in trust at the conclusion of the representation. Likewise, when it is anticipated that settlement funds will go through the trust account, with fees, costs, and perhaps third party claims satisfied therefrom, this should be explained in the agreement.

Advanced/Retainer Fees

The meaning of the word "retainer" varies from lawyer to lawyer. In the classic sense of the word, a "retainer" was paid to reserve the attorney's time and was not intended as an advance payment against hourly fees for a specific matter. That classic model is not in common use

anymore, though annual retainers may remain in use in smaller communities. If you use an annual retainer, bear in mind that conflicts and similar problems can still arise.

More commonly, a "retainer" refers to an advance fee paid in anticipation of representation, which is standard in most areas of law. These fees belong to the client until the lawyer earns them, and therefore must be kept in trust until earned.

"Non-Refundable" Fees

Older precedent (*e.g.*, Ethics Op. E-93-4) suggested non-refundable fee agreements were enforceable, so long as (1) the fee was reasonable in amount at the time of the contract, and (2) the lawyer was not discharged *for cause*. However, the OLR's position has been that even if (a) the client agreed to a non-refundable fee, (b) the fee was reasonable prospectively, and (c) the lawyer was not discharged for cause, the lawyer may still have to surrender part of the fee if discharged, based on SCR 20:1.16(d):

> **SCR 20:1.16** ***Declining or terminating representation***
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> (d) 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 or expense that has not been earned or incurred.*

(Italics added). Changes to the Supreme Court Rules in 2007 now make the OLR's position "black letter" law. See SCR 20:1.0(ag):

> **SCR 20:1.0** ***Terminology***
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> (ag) "Advanced fee" denotes an amount paid to a lawyer in contemplation of future services, which will be earned at an agreed-upon basis, whether hourly, flat, or another basis. *Any amount paid to a lawyer in contemplation of future services whether on an hourly, flat or other basis, is an advanced fee regardless of whether that fee is characterized as an "advanced fee," "minimum fee," "nonrefundable fee," or any other characterization.* Advanced fees are subject to the requirements of SCR 20:1.5, SCR 20:1.15 (b) (4) or (4m), SCR 20:1.15(e) (4) h., SCR 20:1.15 (g), *and SCR 20:1.16 (d).*

(Italics added). Does this mean that a prematurely discharged lawyer defending a *civil* suit brought by a client for return of fees will lose? Not necessarily. *Cf. Yorgan v. Durkin*, 2006 WI 60, 290 Wis. 2d 671, 715 N.W. 2d 160 and *Disciplinary Proceedings Against Barrock*, 2007 WI 24, 299 Wis. 2d 207, 727 N.W.2d 833.

It does mean that advance fees, however denominated, must be placed in the trust account (because they do not belong to the lawyer until "earned"), *unless* the lawyer complies with the conditions of SCR 20:1.15(b)(4m):

> **SCR 20:1.15(b)(4m)** ***Alternative protection for advanced fees.***
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> A lawyer who accepts advanced payments of fees may deposit the funds in the lawyer's business account, provided that a court of competent jurisdiction must ultimately approve the lawyer's fee, or that the lawyer complies with each of the following requirements:
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> a. *Upon accepting any advanced payment of fees* pursuant to
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> this subsection, *the lawyer shall deliver to the client a notice* in writing containing all of the following information:
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> 1. the amount of the advanced payment;
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> 2. the basis or rate of the lawyer's fee;
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> 3. any expenses for which the client will be responsible;
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> 4. *that the lawyer has an obligation to refund any unearned advanced fee*, along with an accounting, at the termination of the representation;
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> 5. *that the lawyer is required to submit any dispute about a requested refund of advanced fees to binding arbitration* within 30 days of receiving a request for such a refund; and
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> 6. the ability of the client to file a claim with the Wisconsin lawyers' fund for client protection if the lawyer fails to provide a refund of unearned advanced fees.
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> b. *Upon termination of the representation, the lawyer shall deliver to the client in writing* all of the following:
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> 1. a final accounting**,** or an accounting from the date of the lawyer's most recent statement to the end of the representation, regarding the client's advanced fee payment with a refund of any unearned advanced fees;

2. *notice that, if the client disputes the amount of the fee and wants that dispute to be submitted to binding arbitration, the client must provide written notice* of the dispute to the lawyer within 30 days of the mailing of the accounting; and

3. notice that, if the lawyer is unable to resolve the dispute to the satisfaction of the client within 30 days after receiving notice of the dispute from the client, the lawyer shall submit the dispute to binding arbitration.

c. Upon timely receipt of written notice of a dispute from the client, the lawyer shall attempt to resolve that dispute with the client, and if the dispute is not resolved, the lawyer shall submit the dispute to binding arbitration with the State Bar Fee Arbitration Program or a similar local bar association program within 30 days of the lawyer's receipt of the written notice of dispute from the client.

d. Upon receipt of an arbitration award requiring the lawyer to make a payment to the client, the lawyer shall pay the arbitration award within 30 days, unless the client fails to agree to be bound by the award of the arbitrator.

(Italics added). As a practical matter, the fee must also, in retrospect, be "reasonable" pursuant to SCR 20:1.5.

2. During representation, handle client and third-party funds properly.

SCR 20:1.15(b)(1) ("Segregation of trust property") states:

Separate account. A lawyer shall hold in trust, separate from the lawyer's own property, that property of clients and 3rd parties that is in the lawyer's possession in connection with a representation. All funds of clients and 3rd parties paid to a lawyer or law firm in connection with a representation shall be deposited in one or more identifiable trust accounts.

By definition, money in trust is not the lawyer or law firm's money (although the lawyer or firm may have an interest in the funds, such as with contingent fees). All property not owned by the lawyer or firm that is in the lawyer or firm's possession in connection with a representation must be placed in a trust account until it is properly earned, accounted for, and disbursed. This includes not only client funds such as advanced fees, but settlement funds as well.

Attorneys will need to make sure they properly identify property that belongs to a client or other third party so that it may be properly placed or retained in a trust account. At some point, however, some property ceases to belong to that client or third party—advanced fees are earned by the lawyer, costs are incurred that need to be paid from the account, or settlement funds need to be divided between the lawyer, client, and any subrogated parties or lienholders. At that time, funds need to be disbursed from the trust account. Knowing who the funds belong to at various points in representation, and keeping accurate records pertaining to same, will simplify and streamline the process.

3. Trust account practices during representation.

Hourly Fees

Lawyers commonly use advanced fees to ensure prompt payment for matters billed hourly. Once the fees have been earned and clients have been provided with invoices and an opportunity to object, lawyers may properly accept payment for the fees by disbursing trust funds. The process is governed by SCR 20:1.15(g):

> **SCR 20:1.15(g):** ***Withdrawal of non-contingent fees from trust account.***
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> (1) *Notice to client. At least 5 business days* before the date on which a disbursement is made from a trust account for the purpose of paying fees, with the exception of contingent fees or fees paid pursuant to court order, *the lawyer shall transmit to the client in writing* all of the following:
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> a. an *itemized bill or other accounting* showing the services rendered;
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> b. notice of the *amount owed* and the *anticipated date of the withdrawal*; and
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> c. *a statement of the balance of the client's funds in the lawyer trust account after the withdrawal*.
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> (1m) *Alternative notice to client.* The lawyer may withdraw earned fees on the date that the invoice is transmitted to the client, *provided that the lawyer has given prior notice to the client in writing* that earned fees will be withdrawn on the date that the invoice is transmitted. The invoice shall include each of the elements required by sub. (g) (1) a., b., and c.

(2) *Objection to disbursement.* If a client makes a particularized and reasonable objection to the disbursement described in sub. (g) (1), the disputed portion shall remain in the trust account until the dispute is resolved. If the client makes a particularized and reasonable objection to a disbursement described in sub. (g)(1) or (1m) within 30 days after the funds have been withdrawn, the *disputed portion shall be returned to the trust account until the dispute is resolved, unless the lawyer reasonably believes that the client's objections do not present a basis to hold funds in trust or return funds* to the trust account under this subsection. The lawyer will be presumed to have a reasonable basis for declining to return funds to trust if the disbursement was made with the client's informed consent, in writing. The lawyer shall promptly advise the client in writing of the lawyer's position regarding the fee and make reasonable efforts to clarify and address the client's objections.

Flat Fees

Consider using the notice from SCR 20:1.15(b)(4m) ("Alternative protection for advanced fees"), above, when representing a client on a flat fee basis. Consider designating in your fee agreement that portions of the flat fee will be deemed earned as of certain stages of the representation, and then use SCR 20:1.15(g) ("Withdrawal of Non-Contingent Fees From Trust Account"), above.

Recordkeeping

For specific bookkeeping requirements, see SCR 20:1.15, and the OLR's "Managing Your Client Trust Account MANUAL & WORKBOOK," available at: www.wicourts.gov/services/attorney/docs/trustaccountmanual.pdf.

In brief, lawyers must maintain the following:

(1) G**eneral ledger** for the trust account (sometimes referred to as a "Transaction Register") showing all deposits, disbursements, and running balances after each transaction for the trust account.

(2) **Subsidiary ledgers** (or "Client Ledgers") for each person for whom you hold money in trust, including a chronological record of deposits, disbursements, and running balances.

(3) **Ledger for account fees and charges** for any funds deposited in the trust account to accommodate monthly service charges.

(4) **Deposit records** (deposit slips identifying the amount of each deposit, the client, and the date).

(5) **Disbursement records** (copies or images of canceled checks, wire transfer records, etc.).

(6) **Monthly statements** from the bank.

(7) **Reconciliation reports** (printed reconciliation reports, prepared at least every 30 days, showing the balance in the transaction register, the total of all subsidiary ledger balances, and the adjusted balance, determined by adding outstanding deposits and other credits to the balance in the bank's monthly statement and subtracting outstanding checks and other deductions from the balance in the monthly statement).

All records must be maintained for at least six years after termination of a representation. It is also important to maintain a backup of these records, whether you keep records electronically or on paper. Some attorneys may find record- and book-keeping onerous or outside of their experience, and may find it helpful to utilize software, an employee, or a contractor to manage these tasks. Remember, even if the tasks are delegated, the attorney ultimately remains responsible for proper trust accounting and recordkeeping.

4. Trust account practices and handling funds at the conclusion of representation.

If the task for which the attorney has been retained has been completed and funds remain in trust, attorneys will need to wind down representation and disburse and, if warranted, refund fees.

Advanced and flat fees are governed by SCR 20:1.15(g), as described above. Contingent fees, which by definition do not come in to the trust account until the substance of representation is concluded, are governed by SCR 20:1.15(d):

> **SCR 20:1.15(d):** ***Prompt Notice and Delivery of Property.***
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> (1) *Notice and disbursement.* Upon receiving funds or other property in which a client has an interest, or in which the lawyer has received notice that a 3rd party has an interest identified by a lien, court order, judgment, or contract, the lawyer shall promptly notify the client or 3rd party in writing. Except as stated in this rule or otherwise permitted by law or by agreement with the client, the

> lawyer shall promptly deliver to the client or 3rd party any funds or other property that the client or 3rd party is entitled to receive.
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> (2) *Accounting.* Upon final distribution of any trust property or upon request by the client or a 3rd party having an ownership interest in the property, the lawyer shall promptly render a full written accounting regarding the property.
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> (3) *Disputes regarding trust property.* When the lawyer and another person or the client and another person claim ownership interest in trust property identified by a lien, court order, judgment, or contract, the lawyer shall hold that property in trust until there is an accounting and severance of the interests. If a dispute arises regarding the division of the property, the lawyer shall hold the disputed portion in trust until the dispute is resolved. Disputes between the lawyer and a client are subject to the provisions of sub. (g)(2).

Fee Disputes

While fee disputes between lawyers and clients have relatively clear pathways for resolution (*e.g.*,litigation or, if agreed to, arbitration through the State Bar of Wisconsin and some local bar associations), lawyers' obligations to third parties who claim an interest in trust property deserve attention and may not be terribly intuitive. These third parties can range from subrogated insurers, past attorneys or physicians claiming a lien, to a former spouse entitled to settlement funds due to a divorce judgment.

Case law, which continues to evolve, suggests that while lawyers may not face civil liability for disbursing trust property over a third party's claimed interest, it nonetheless could subject them to discipline. For example, *Yorgan v. Durkin*, 2006 WI 60, 290 Wis. 2d 671, 715 N.W.2d 160, involved an attorney who settled a client's personal injury claim and received the associated proceeds. The attorney did so while aware that the client's chiropractor was owed payment and that the client had executed a document purportedly giving the chiropractor a lien on settlement proceeds. After the lawyer attempted to negotiate a reduction in the amount owed, the lawyer disbursed the settlement proceeds without paying the chiropractor. The chiropractor sued the lawyer and the Court held that because the lawyer was not a party to a contract regarding a lien or responsibility for the chiropractor's bills, the lawyer could not be held liable for money damages.

On the other hand, *In re Disciplinary Proceedings Against Barrock*, 2007 WI 24, 299 Wis. 2d 207, 727 N.W.2d 833, dealt with, among other issues, a lawyer making a disbursement of trust

funds while aware of an asserted lien. As in *Yorgan*, the lawyer was not a party to the relevant contract. The Court nevertheless held that the disbursement violated SCR 20:1.15(d), and imposed discipline. While a dissenting opinion argued that *Yorgan* precluded finding a violation of 1.15(d), a concurring opinion pointed out that the *Yorgan* court was silent as to whether the attorney violated the Supreme Court Rules.

Nonetheless, even where knowledge of asserted third party claims does not make an attorney liable for disbursing funds without regard for a claim, it exposes a lawyer to discipline. This can put the lawyer in the uncomfortable position of acting as the third party's collection agency (which is why attorney's obligations regarding third party claims to trust property should be explained very clearly to clients). Moreover, it can be a hassle. Where there are legitimate reasons to question a third party's bill, for example, this requires additional time and attention and the disputed funds must be retained in trust pending agreement or other resolution.

Where the facts of a particular situation make it worthwhile, an option to consider is turning to a court to decide who gets paid what. For example, in a personal injury matter where a medical provider is claiming what appears to be an exorbitant or frivolous lien, it may be helpful to implead the provider so the legitimacy of the lien can be determined with finality and by force of court order.

5. Wind down representation with an accurate accounting and closing letter.

As stated above, funds must be accounted for at the termination of representation. Disengagement letters or closing statements are useful as a means of providing the required trust accounting and demonstrating to the clients what their money was used for. While not every fee dispute can be avoided, complying with Supreme Court Rules will help prevent a fee dispute from escalating into a malpractice claim or disciplinary investigation. Ending representation on the right note will demonstrate commitment and professionalism to clients, and they will be more likely to keep you in mind the next time they need a lawyer.