

Managing Client Funds

Danny M. Howell
Law Offices of Danny M. Howell, PLLC
McLean, Virginia
www.dmhowelllaw.com

How To Get In Trouble With The Bar: Mishandling IOLTA Accounts

The comment to ABA Model Rule 1.15 on Safekeeping Property states, a lawyer "should hold property of others with the care required of a professional fiduciary." When a client complains to the bar about mishandling client funds, or when the bank reports to the bar that the attorney's IOLTA account has a negative balance, those reports go to the top of the heap and generate an immediate investigation. There simply is no easier or quicker way to get in trouble with the bar than to mishandle the client trust account.

How To Avoid Trust Account Errors

The article "Managing Your Client Trust Account: Where the Buck Stops" by Sheila M. Blackford (*Law Practice*, Vol. 37 No., Jan./Feb/ 2011) has an excellent rundown of advice for avoiding trouble, and instructions for necessary records that must be kept and retained (typically for five years, although some jurisdictions require a longer period). Blackford's advice includes:

- Always remember that money that belongs to your client belongs in your trust account—and until you've actually earned the money, it continues to belong to your client. Caveat: Some lawyers like to use "earned upon receipt" fee agreements so the money can be put into their general account, thereby avoiding the need to use a trust account. Be sure to check your state rules governing this type of fee arrangement before you try to write one.
- Explain in your fee agreement how you apply money held in your trust account toward the legal fees and costs incurred. Also explain that a statement will be provided showing these charges, along with the balance and any amount that's needed to replenish the trust account balance to a required minimum balance, known as an "evergreen account."

- Only use funds in the trust account for client's expenses. Write a trust account check payable to your firm and deposit it into your general account and then write a general account check to pay for your associated overhead expenses.
- Wait an appropriate amount of time for deposits to clear before writing a trust account check. Be careful to verify that funds have been collected and are in the account first.

Avoiding Trust Account Scams

a. Fraudulent Cashier's Checks

Fraudulent cashier's check scams target solos and have become more sophisticated over time. Their hallmarks are: (a) contact over the internet, (b) use of real companies' and company officials' names, (c) requesting what appears to be straightforward commercial work, and (d) paying the attorney with a cashier's check *written for an amount far greater than the moneys owed*, with instructions to wire the moneys to a foreign account as soon as the monies are "available." The latter bit is the heart of the scam – funds are often made "available" by the bank within a day of deposit – but it's just a loan given to the customer until the check is collected from the issuing bank. By the time the supposed issuing bank advises the attorney's bank that the check is fraudulent, the money is long gone; the trust account has a huge deficit; and the attorney must make the deficit up right away in order to avoid being out of trust and subject to bar discipline.

To add to the misery, the Bank will likely freeze all the attorney's accounts and sue the attorney for its loss on the fraudulent check, relying on its deposit and wire transfer agreements. In most cases, such claims are not covered under the attorney's professional liability insurance policy; and the loss is easily enough to force the attorney or law firm into bankruptcy. (Note that deposit agreements may make the attorney jointly liable with the professional corporation, exposing the lawyer's personal assets.)

The best way to avoid a cashier's check scam is to spot the red flags associated with the scam: checks issued by a non-local bank, client instructions that insist on immediate wiring of funds, wires to be sent to foreign banks, and most importantly, checks written for an amount greater than what you are owed for legal fees. Never take such a check. Period.

Hacking and Fraudulent Wire Transfer Instructions

How the Hacking Scam Works

Wire transfer fraud involves hackers who gain access to the e-mail accounts of one or more parties to a real estate deal, or to their attorneys' or real estate agents' accounts. Once the scammers find out the particulars and timing of an upcoming wire transfer, they send what purports to be new instructions from the client, agent, broker, seller's attorney, etc., directing a new bank to receive the wire transfer.

These are usually sophisticated scams. The e-mail address looks valid, the message will likely mention details of the transaction that the scammer has learned from the hacked communications, and which make the e-mail appear legitimate.

Attorneys who fail to take appropriate steps to guard against and identify hacking schemes can find themselves on the wrong end of a bar complaint (not to mention a malpractice suit or other civil liability action).

The Ethical Rules

Paragraph (c) of Model Rule 1.6 explains:

A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client.

This excerpt from Comment 18 to Rule 1.6 is highly relevant to ethical obligations to protect against hacking:

Factors to be considered in determining the reasonableness of the lawyer's efforts include, but are not limited to, the sensitivity of the information, the likelihood of disclosure if additional safeguards are not employed, the cost of employing additional safeguards, the difficulty of implementing the safeguards, and the extent to which the safeguards adversely affect the lawyer's ability to represent clients (e.g., by making a device or important piece of software excessively difficult to use). A client may require the lawyer to implement special security measures not required by this Rule or

may give informed consent to forgo security measures that would otherwise be required by this Rule.

Red Flags

There are a number of red flags that should alert you to suspect a hacker. Typically, the new wire information will instruct that the funds be wired to a non-local (or even a foreign) bank. Most closing agents use local banks or regional banks to handle their money. New instructions telling you to wire to a bank on the other side of the country (or the planet) should be a red flag.

Watch out if the instruction comes from a person you have not been dealing with at the company. The name is typically that of a real employee -- but the e-mail is fraudulent.

The new instructions typically come in shortly before the closing and contain all sorts of language telling you to hurry up and get the wire done.

How to Protect Yourself

Always verify changes to wire instructions by speaking to your client, telephoning the client using a number you know to belong to your client. Speak to the client (or if the client is an entity, to someone you know who works for the client) and verify the e-mail. Insist that the client confirm to you in writing the legitimacy of the new wiring instructions. Do not rely on any instructions contained in the suspect e-mail regarding phone numbers to call or other verification procedures.

A number of steps should be taken generally with regard to Rule 1.8 compliance. Avoid the use of free, web-based email programs such as Gmail and/or Yahoo. Establish a company website domain and use it to establish company email accounts.

Train all your employees, including paralegals and assistants, on the fraud scams and how to avoid falling for them, especially the steps for how to verify the instructions. This so-called "second-factor authentication" should be a written requirement sent to all your employees.

Consult with information technology experts to make sure your firm has in place proper virus, malware and hacking protection software.

Letting Paralegals Handle Client Funds.

Sanctions arising out of the use of paralegals frequently involve situations in which the paralegal was permitted to handle funds. In Matter of Castelli, 131 A.D.3d 29, 31 (N.Y. App. Div. 2015), an attorney was held to have aided the unauthorized practice of law when, although he was the sole signatory on his attorney trust (“IOLTA”) account, he authorized his paralegal to use his signature stamp to sign settlement checks and deposit them in the account, as well as to issue IOLTA account checks to clients when disbursing their settlement proceeds. Utilizing the password provided by the respondent, Taradash accessed the IOLA account to conduct online transactions, and misappropriated client funds.