

Trust Accounts in Virginia and D.C.

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Agenda

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Agenda

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Part I: The Basics

What is a Trust Account?

- What is a trust account?
- A lawyer's trust account is where the lawyer holds client funds or funds belonging to third parties arising out of a representation. D.C. Rules of Prof'l Conduct r. 1.15(a); Va. Rules of Prof'l Conduct r. 1.15(a)
- In D.C., the trust account must be entitled "[Law Firm Name] Trust Account/Escrow Account." D.C. Rules of Prof'l Conduct r. 1.15(b).
- Virginia has no specific rule on labeling, but a trust or escrow account must be labeled as such.

What is a Trust Account?

- If the trust account is an IOLTA account, it must be entitled “[Law Firm Name] D.C. IOLTA Account/IOLTA Account.” D.C. Rules of Prof’l Conduct r. 1.15(b).
- There is no explicit requirement in Virginia to that effect, but specific labeling is a best practice.

What is an IOLTA Account?

- An IOLTA account is a type of Rule 1.15 trust account. IOLTA stands for “Interest on Lawyer Trust Accounts.”
- An IOLTA account pays interest but remits that interest to—
 - In D.C.: The D.C. Bar Foundation, to support its programs and activities.
 - In Virginia: The Legal Services Corporation of Virginia, to support its programs and activities.

What is an IOLTA Account?

- In D.C., a lawyer must deposit funds that are “nominal in amount or expected to be held for a short period of time and as such would not be expected to earn income for the client or third party in excess of the costs incurred to secure such income” in an IOLTA account. D.C. Rules of Prof’l Conduct r. 1.15(b).
- Virginia no longer allows lawyers to “opt out” of IOLTA. Under the new rule, attorneys who maintain pooled non-interest-bearing trust accounts must convert these to IOLTA. Compliance is **required by July 1, 2023**.

What is an IOLTA Account?

- A lawyer will not be second-guessed on a good faith judgment about whether funds might earn income for the client/third party in excess of the relevant costs. D.C. Rules of Prof'l Conduct r. 1.15 cmt. [6]. Va. Sup. Ct. R. 6:4 ¶ 20(b)(1).

What is an IOLTA Account?

- Lawyers who principally practice in D.C. have to have a D.C. IOLTA account. Otherwise, participation in another jurisdiction's IOLTA program is sufficient for a D.C.-admitted lawyer practicing elsewhere. D.C. Rules of Prof'l Conduct r. 1.15(b).
- In Virginia, Rule 1.15(a)(2) provides: "For lawyers or law firms located in Virginia,
 - a lawyer trust account shall be maintained only at a financial institution approved by the Virginia State Bar,
 - unless otherwise expressly directed in writing by the client for whom the funds are being held."(formatting added).

Some additional discussion in the next section!

What is an IOLTA Account?

- The determination of where a “lawyer principally practices” is not just based on the location of the lawyer’s office. See D.C. Rules of Prof’l Conduct r. 1.15 cmt. [5].
- An IOLTA account can be a “pooled” account—i.e., one account for the funds of all of a firm’s client or third party funds.

What is an IOLTA Account?

- Questions about setting up an IOLTA?
- Contact:
 - The D.C. Bar's free and confidential Practice Management Advisory Service.
<http://www.dcbar.org/bar-resources/practice-management-advisory-service/>;
 - The D.C. Bar Ethics Hotline (202-737-4700, ext. 1010);
 - The Virginia State Bar Ethics Hotline (804-775-0564).

Typical Use of Trust Accounts

- Advance payments (“retainers”) from clients, or evergreen retainers.
- Settlement funds—i.e., when the lawyer receives funds as a result of the resolution of a matter that includes funds due to a client or third parties (vendors, experts, client creditors).
- Flat fees. *See* D.C. Ethics Op. 355 and *In re Mance*, 980 A.2d 1196 (D.C. 2009).

Typical Use of Trust Accounts

- Client overpayments or double payments.
 - A lawyer can either send the check back or put it into the trust account.
 - A lawyer cannot put the funds into an operating account and then transfer the excess to trust.
 - A lawyer cannot put the funds into an operating account and credit the client with the excess (i.e., “on account cash”). Va. Bar Trust Accounting FAQs, 1(b) (<http://www.vsb.org/site/regulation/trust-accounting-FAQs>).

What Goes In

- Advance payments;
- Settlement funds that include amounts belonging to others;
- Overpayments and double payments;
- Fiduciary funds.

What Goes In

- Plus the lawyer can put in a small amount of the lawyer's own funds to cover bank charges. D.C. Rules of Prof'l Conduct r. 1.15(f).
- This is a good idea. Otherwise a bank charge can result in a trust check being returned for insufficient funds, in which case the bank automatically notifies D.C. Disciplinary Counsel or Virginia Bar Counsel.

What Comes Out

- Funds that the lawyer has earned per the engagement agreement;
- Expenses that the lawyers has paid on behalf of the client that the client is obligated to reimburse;
- Funds that the client has agreed are due to third parties – often service providers who have agreed to be paid at the end of the case.

What Comes Out

- Funds owed to the client because of a settlement or verdict;
- Unearned fees/unspent expense advances by the client, including refunds due to the client because the client has terminated the lawyer.

When

- Promptly, as earned by lawyer; after receipt for funds due to clients or third parties; after demand by the client for a refund of unearned funds. D.C. Rules of Prof'l Conduct r. 1.15(c); Va. Rules of Prof'l Conduct r. 1.15(b).
- With checks, the funds going in must clear. Make sure that the check has really cleared—don't assume it has cleared after three business days.

When

- Leaving earned funds in the account is commingling, which violates Rule 1.15 of the D.C. Rules of Professional Conduct.
- And, clients and third parties should be notified promptly when funds are received (*i.e.*, settlements/verdicts). D.C. Rules of Prof'l Conduct r. 1.15(c); Va. Rules of Prof'l Conduct r. 1.15(b).

How

- For moneys earned by the lawyer (for fees or reimbursement of expenses) by a check or transfer to the lawyer's operating account.
- A lawyer should never pay the lawyer's debts or obligations directly from a trust account.
 - Don't pay rent with trust checks.
 - Pay the funds to an operating account.

How

- A lawyer does not have to make separate withdrawals for each client. A lawyer can, for example, make monthly withdrawals of all funds earned from clients who have funds held in a trust account for the purpose of paying legal fees.

How

- However, the lawyer needs to keep records that show the breakdown of a trust check to the lawyer's operating account, client by client. D.C. Rules of Prof'l Conduct r. 1.15 cmt. [2]; Va. Rules of Prof'l Conduct r. 1.15(c)(1)&(2).

How

- For settlements/verdicts to be disbursed to the lawyer, client and third parties, only after the lawyer prepares and the client signs a settlement sheet which shows the total received and how that total is to be disbursed. D.C. Rules of Prof'l Conduct r. 1.5(c); Va. Rules of Prof'l Conduct r. 1.5(c).

Part II: D.C. vs. Virginia

Summary: Main Differences Between DC and Virginia

- Fundamentally, the rules are quite similar, but there are differences in the specific details.
- **Labeling Requirement:** D.C. Rule is more specific.
- **Recordkeeping Requirements:** Virginia rule has more specific requirements.
- **Accounting and Reconciliation Procedures:** Virginia rule states the requirements with more specificity.
- **Supervision:** The Virginia rule has more specific supervision requirement.

Trust Account Record Keeping Requirements

- D.C. says keep “complete records.”
 - Records that themselves “tell the full story of how the client handled client or third party funds and whether the attorney complied with his fiduciary obligation that client funds not be misappropriated or commingled.”
 - Records are not “complete” unless questions about “client funds can be answered without assistance from the lawyer or the lawyer’s clients.”
 - D.C. Rules of Prof’l Conduct r. 1.15 cmt. [2].

Trust Account Record Keeping Requirements

- Virginia is more specific.
 - A lawyer must keep a receipts and disbursements journal with:
 - Client/matter
 - Date and amount of transaction
 - Name of the payor or payee
 - Manner in which funds were received, disbursed, or transferred
 - Current balance.
 - *See Va. R. 15(c)(1).*
- Virginia also requires individual client ledgers for each client whose funds are ever placed in a trust account.

Trust Account Record Keeping Requirements

- Such ledgers must account for all payments received by date, amount, payor and form of payment; and also for all disbursements or transfers, again by date, amount, payee and form of disbursement or transfer.
- A lawyer should be able to specify the amount of funds held on behalf of the client at any particular date from the first date that funds are received until all funds have been disbursed.
- Va. Rules of Prof'l Conduct r. 1.15(c)(2).

Trust Account Record Keeping Requirements

- In addition, the lawyer should be able to break down the total balance of a trust account and identify the clients who have funds in the account and the amount of those funds on per client basis.

Trust Account Record Keeping Requirements

- Both Virginia and the District require that lawyers keep trust records for at least five years after the end of a representation. D.C. Rules of Prof'l Conduct r. 1.15(a); Va. Rules of Prof'l Conduct r. 1.15(c)(4).
- (This requirement may make switching accounting systems more difficult.)

Trust Account Record Keeping Requirements

- Virginia requires monthly reconciliations:
 - Must reconcile the client ledger balance for each client
 - Must reconcile the trust account balance (adjust bank statement for any transactions not shown). Adjusted balance must equal balance in checkbook or transaction ledger; and
 - Must reconcile the trust account balance and the client ledger balance. The trust account balance must equal the client ledger balance.
 - Va. Rules of Prof'l Conduct r. 1.15(d)(i)-(iii).
- These are reconciliations within different parts of the firm's internal accounting system.

Trust Account Record Keeping Requirements

- D.C. does not require the reconciliations spelled out in the Virginia Rule but they are essential to trust account management.
- Reconciling the internal trust account balance with the bank statement is not sufficient, either to meet D.C.'s "complete records" requirement or the provisions of Va. Rules of Prof'l Conduct r. 1.15(d).

Trust Account Record Keeping Requirements

- Many commonly used general accounting, time-keeping and billing systems do not have the features necessary to comply with trust account record keeping requirements.

Supervision Requirements

- D.C.'s supervision requirement is same for trust accounts as it is for other matters.
- Under D.C. Rules of Prof'l Conduct r. 5.1 and 5.3, a supervisory lawyer must make "reasonable efforts" to ensure that "the firm has in effect measures that give reasonable assurance" the lawyers and non-lawyers are complying with the D.C. Rules.
- *See In re Robinson*, 74 A.3d 688 (D.C. 2013) (multiple insufficient funds checks with adequate supervision before first insufficient funds trust check but not thereafter).

Supervision Requirements

- Again, Virginia has more specific requirements.
- Virginia requires that a lawyer approve of all of the reconciliations required under the Virginia Rules. Va. Rules of Prof'l Conduct r. 1.15(d)(4).

Choice of Law

- As noted above, DC expressly addresses choice of law for trust accounts in Rule 1.15, providing that lawyers and firms in DC need to comply with the DC rules, and that DC lawyers located elsewhere need only comply with another jurisdiction's trust accounting rules.

Choice of Law

- When do the Virginia trust account apply?
 - If a lawyer and firm are located outside Virginia but working on a Virginia matter, do the stricter requirements of 1.15(b) and (c) apply?
 - In theory, they do, because location of the firm or lawyer in Virginia only matters for Rule 1.15(a). So safest to comply with those requirements if taking on matters in Virginia.
 - But there is little or no evidence of discipline on these grounds if complying with another state's trust account rules.

Choice of Law

- Other states do apply Virginia's Rule 1.15 to lawyers whose offices are in Virginia, even if matters take place elsewhere. *See Att'y Grievance Comm'n of Maryland v. Yi*, 470 Md. 464, 497, 235 A.3d 963, 982 (2020)

Part III: Advanced Topics

Flat Fees

- Flat fees must be put into a trust account and kept in the trust account until earned.
- A lawyer can make withdrawals of portions of the flat fees at certain matter milestones, as reflected in the engagement letter or otherwise agreed by the client.
- *See Mance*, 980 A.2d at 1204; D.C. Ethics Op. 355; *see also* Va. Ethics Op. 1606.

Non-Refundable Retainers/Advance Payments

- These almost always violate the ethics rules as they unduly burden a client's otherwise unfettered right to discharge a lawyer.
- *See* D.C. Ethics Op. 264 (note that the discussion of Rule 1.15(d) in that opinion has been superseded by subsequent rule changes); Va. Ethics Op. 1606.
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Non-Refundable Retainers/Advance Payments

- Note that there is an exception for “availability” or “general retainers” which are payments to the lawyer simply to assure the lawyer’s availability to take a matter and which are not for services rendered.
- These retainers are rarely justified and also cannot be used to pay for any legal services.
- *See generally* D.C. Ethics Op. 264, Va. Ethics Op. 1606, and *Mance*, 980 A.2d.

Overpayments and Double Payments

- If a client overpays a bill or pays a bill twice by check, the check must be placed in the lawyer's trust account.
- After the check clears the lawyer must move the portion of the check that represented earned funds into an operating account.
- The check should not be deposited into an operating account in the first instance. Va. Rules of Prof'l Conduct r. 1.15(d)(2).

Overpayments and Double Payments

- If the client wires funds that are immediately available, then the lawyer can and should promptly transfer the funds as appropriate.
- If the client wires the payment to an operating account, the unearned portion must be transferred to a trust account.
- If the client wires the funds to a trust account, the earned portion must be transferred to an operating account.

Client Refunds

- When a matter is concluded or the client terminates the lawyer's services, the lawyer must promptly refund any unearned funds to the client. D.C. Rules of Prof'l Conduct r. 1.16(d); Va. Rules of Prof'l Conduct r. 1.16(d).
- Note: for fixed fee matters, the engagement letter should provide for a fair and reasonable method to compute what the lawyer has earned up to the point of termination by the client.

Funds Owed to Third Parties

- Funds owed to third parties relating to a representation must also be held in trust.
- Often, such third parties are experts or service providers who agree to defer payment until a contingency case is resolved and have the agreement of the client to be paid from a recovery.

Funds Owed to Third Parties

- Other third parties with “just claims.” See *In re Bailey*, 883 A.2d 106, 115 (D.C. 2005); D.C. LEC 293.

Disputes

- If there is a dispute among a client, third party or the lawyer as to funds held in a trust account, the lawyer must hold the disputed portion in trust until the dispute is resolved, by agreement or otherwise.
- A lawyer should not disburse funds to client as to which a third party has a just claim simply based on a client instruction. *In re Bailey*.
- The undisputed portion of the funds held by the lawyer should be disbursed. D.C. Rules of Prof'l Conduct r. 1.15(d); Va. Rules of Prof'l Conduct r. 1.15(b)(3)(ii).

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Disputes

- If the client challenges a lawyer's fee after the fee has been paid, the lawyer should put the disputed amount into the lawyer's trust account. *In re Martin*, 67A.3d 1032, 1044-45 (D.C. 2013).

Credit Cards and Trust Accounts

- A lawyer can accept credit cards for advance fee payments.
- The lawyer should either credit the face amount of the charge or obtain the client's written agreement that the lawyer will only credit the net amount (less credit card discounts and fees).

Credit Cards and Trust Accounts

- Many credit card companies assess monthly fees and discounts on an account-wide basis and do not allocate discounts and fees among individual payments made to the trust account.

Credit Cards and Trust Accounts

- This means that the client's charge shows up on the bank statement as a gross amount, without regard to fees or discounts. The fees and discounts are assessed often the next month, in a lump sum.
- As a result, assessing individual clients with their share of such fees and discounts can be an accounting nightmare.

Credit Cards and Trust Accounts

- The best practice with respect to credit card fees and discounts is to have them assessed by the lawyer's bank against the operating account, not the trust account.
- Otherwise, the lawyer has to place funds into the trust account to cover the discounts and fees, without knowing exactly what those discounts and fees will be since they can be assessed after the charge is made by the client and the funds are received by the lawyer

Credit Cards and Trust Accounts

- Other payment mechanisms such as PayPal may deduct their fee before the funds hit the trust account.
- This means that unless the client pays more so that the lawyer gets the full amount, the trust account will receive less than the amount paid by the client.
- This also creates accounting issues, particularly when the lawyer has to determine how much to withdraw after services are rendered and fees earned.

Credit Cards and Trust Accounts – Hypo #1

- Five clients hire a lawyer in May and all make advance payments via credit card.
 - The advance payments total \$25,000 (\$5,000 each).
 - The May bank statement shows the receipt of \$25,000.
 - The trust balance is \$25,000.
- In June, the lawyer does \$2,500 of work on each case and sends out bills totaling \$12,500.
 - The June trust bank statement has \$750 in fees and discounts assessed by the credit card company.
 - The lawyer transfers \$12,500 to an operating account.
 - The trust balance is now \$11,750.

Credit Cards and Trust Accounts – Hypo #1, cont.

- In July, the lawyer does \$2,500 of work on each case in July and transfers \$12,500 to an operating account. There are insufficient funds to make the transfer and Disciplinary Counsel is notified

PayPal- Hypo #2

- The lawyer takes a \$1,000 transfer through PayPal as an advance payment into the trust account. PayPal only sends \$950 into the account. Afterwards, the lawyer does \$1,000 in work and then transfers \$1,000 from the trust account to an operating account.
- In effect, the lawyer is borrowing \$50 from other clients who funds are in the trust account, unless the lawyer places \$50 of operating funds into the trust account in advance to cover the PayPal charge.

PayPal- Hypo #2, cont.

- Even if the lawyer places \$50 into the account, she may still be in violation as the Rule. D.C. Rule 1.15(f) only allows a lawyer only to put in her own funds to “defray[] bank charges” and PayPal fees are not “bank charges.”
- And PayPal receipts vary by month so the charges will vary by month. How will the lawyer know how much to put into the trust account to defray such charges?

Payments via Third Parties

- You can't avoid the trust rules by having the client pay a non-lawyer third-party.
- Virginia LEO 1885:
 - For-profit attorney “matching service” offered various limited-scope representations for a “fixed fee.”
 - Consumers paid the matching service, not the lawyer. The matching service held the funds until the lawyer provided the services.
 - Opinion found that this arrangement would violate many rules, including the trust rules.

The (D.C.) Informed Consent Exception

- Forget all of the above (or most of it).
- D.C. Rules of Prof'l Conduct r. 1.15(e) allows a lawyer to keep advances of unearned fees or costs in an operating account with the informed consent of the client. Informed consent is a high burden. *See In re Mance* and D.C. Opinion 355.
- Note that this does not apply to funds received in settlement of a matter, e.g., a personal injury settlement.
- Virginia does not have this exception.

The (D.C.) Informed Consent Exception, cont.

- What disclosures are required to obtain informed consent?:
 - (a) trust accounts exist;
 - (b) they are likely immune from attachment by the lawyer's/law firm's creditors (operating accounts are not);
 - (c) trust funds cannot be spent until earned—by doing work for the client.
 - (d) funds held in an operating account can be spent without restriction (e.g. Vegas trips);
 - (e) trust funds are readily available for refund if the lawyer is terminated or funds are left over after the matter is complete. D.C. Ethics Op. 355.

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The (D.C.) Informed Consent Exception, cont.

- What disclosures are required to obtain informed consent?:
 - The disclosures should be made orally to the client and explained so that the client in fact understands;
 - The disclosure and consent should also be reiterated in writing.

Mistakes

- Analyze what happened.
- Double check.
- Consult with the bank or accounting personnel.
- Look at bank records and internal records.
- Fix the mistake.
- Do it quickly.

Thank you!

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