

Money Mysteries

Understanding the crucial difference between deposited funds and collected funds for lawyer trust accounts

BY CHERYL M. HEUETT

In the June issue of *Washington State Bar News*, attorney and regular columnist Mark J. Fucile wrote an article about scammers posing as clients who target lawyer trust accounts. One of the reasons lawyers¹ get taken by these scams is that they do not wait for the deposits made on behalf of the scammers to be processed and rejected by the bank before disbursing funds to the scammers. In those cases, lawyers have disbursed funds that the bank has made “available” but are not yet in the account.

But what if there is no scam? Even then, disbursing funds based on availability alone puts lawyers at risk. This article takes a look at how making disbursements based on the availability of funds—rather than on funds that have actually been collected by the bank—can affect a lawyer in everyday practice.

WHAT ARE AVAILABLE FUNDS?

When you make a deposit inside a bank, the teller may inform you that a portion of the deposited funds is available immediately. Essentially, the bank is advancing funds to you against the funds that have been deposited but not yet collected by the bank. Sometimes, if you are a good customer, the bank will make the entire deposit available to you immediately.

A bank does not make funds available to its clients out of the goodness of its heart. Sometimes banks make deposited funds available immediately because the bank is required to do so. Under Federal Reserve Board Regulation CC, banks must make a portion of each deposit available to the depositor. Typically, a bank will allow \$100 of a large deposit to be available the first day, \$5,000 one week after the deposit, and the remainder of the deposit two weeks after

the deposit. As stated earlier, the bank may not place any restrictions at all on the deposit and may make the entire amount available to you.

When a bank makes funds available to you sooner than required, that decision is partly based on the assumption that the deposit is going to be collected. If something happens to interfere with the bank’s ability to collect a deposit, those funds will no longer be available. Typically, if a deposit has been made that is not collected, the lawyer will be responsible for replacing any funds that have been disbursed against that deposit until the deposit can be made good.

Scenario 1:

You receive settlement funds of \$100,000 from an insurance company on behalf of your client. You deposit the instrument into your trust account and ask the teller when the funds will be available. The teller replies that all of those funds are available immediately. Great! You go back to the office and call the client who runs down to pick up a check drawn on your trust account and takes it to his or her bank for deposit. Within a couple of days, the check to the client is paid by your bank. Then you get a call from your bank notifying you that your trust account is overdrawn. How is that possible?

Scenario 2:

A client gives you a check for an advance deposit for fees and costs of \$5,000. You deposit the check into your trust account and the banker tells you the funds are available now. You immediately write a check for \$3,000 to secure the availability of an expert witness. Five days later you receive written notice from the bank that the client’s \$5,000 check to you bounced. The expert has already cashed the check you wrote, so your trust account is now short \$3,000. The client is not answering your phone calls or emails. Now what?

WHAT HAPPENED?

In Scenario 1, there are a couple of possible causes for the overdraft. Most likely, the bank decided to put a hold on the deposit after you left and sent you a notice through the mail that you haven't received yet. In that case, the bank has essentially reversed the availability of the funds. If the bank decides to hold the deposit, the checks written against it may not clear.

It's also possible that the deposit was not collected by your bank because the issuer of the payment rejected the endorsement. Insurance companies still use drafts, where the endorsement must be approved by the issuer before the bank will release the funds. Before your bank can collect those funds, you will need to obtain the proper endorsements on the draft and re-deposit it. As an auditor, I've seen it happen many times that the endorsement on the back of a settlement check or draft is rejected because the lawyer forgot to get the client's signature.

Regardless of the reason for the overdraft, your trust account balance is now negative, and by a large amount. Whatever other client funds you had in trust are gone. Are checks written on behalf of other clients going to bounce? The WSBA Office of Disciplinary Counsel (ODC) is almost certainly going to open a grievance against you, whether the overdraft is reported by the bank or you.² Although the type of overdraft that occurred in Scenario 1 is one that a lawyer can probably correct by obtaining the client's endorsement and re-depositing the draft, you need to consider what actions you must take in order to prevent additional overdrafts in the meantime.

In Scenario 2, the lawyer has simply disbursed funds from the trust account that were not there. This is another example of the lawyer relying on the available funds as though they were actually collected. The lawyer will have to replace the \$3,000 that was disbursed to the expert witness and attempt to get the client to replace the initial deposit.

The first reaction many lawyers have is to be angry. Why did the bank say those funds were available and then change its mind? What lawyers have to understand is that even though a bank makes funds available, if the bank cannot collect the funds, the amount of the deposit will be reversed out of the trust account. If disbursements

were made from the funds that were previously available but were uncollectable, those disbursements cause a shortage in the trust account.

A shortage means that there is not enough money in the trust account to cover the total of all client balances that should be held in trust. A shortage can occur even when there is no overdraft.³ That happens when a lawyer disburses more funds on behalf of a client than the client has on deposit, but the trust-account balance overall is not negative. This type of shortage is usually demonstrated by a negative client balance. Disbursing more funds on behalf of a client than are in the trust account is a violation of RPC 1.15A(h)(8).

Whenever a deposit is not collected and is charged back against a trust account, the lawyer must review the trust account records immediately to determine whether he or she has spent any of the deposited funds.⁴ In both scenarios above, the lawyer spent some of the deposit before it had been collected from the bank it was drawn on.

WHAT TO DO ABOUT IT?

Any funds that a lawyer has disbursed against an uncollected deposit must be replaced by the lawyer until the funds he or she deposited can be collected.⁵

Under Scenario 1, if the lawyer has to replace funds approaching \$100,000, he or she may have difficulty. In my time as an auditor, I have seen lawyers who have had to take out mortgages on their homes or borrow money from family members in order to replace funds that were disbursed from a deposit the bank made available but could not collect.

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In Scenario 2, the lawyer's shortage is limited to the \$3,000 used to pay the expert witness and is probably easier to replace, even though \$3,000 is still a significant amount of money. Those funds must be replaced even though there may have been enough funds in the trust account overall to cover that deposit. The funds paid to the expert witness belonged to other clients.

If the \$3,000 in the above scenario is promptly replaced, would the lawyer be subject to discipline? It seems clear that there was a violation of RPC 1.15A(h)(7) because the deposit was, in fact, not collected before funds were disbursed against it. The circumstances of each shortage must be evaluated on a case-by-case basis, but generally the restoration of funds would be taken into account in determining what, if any, disciplinary action was appropriate.

HOW DO YOU KNOW WHEN FUNDS ARE COLLECTED AND CAN BE DISBURSED?

It is understandable, of course, that lawyers are eager to disburse funds that have been received. Clients are usually aware that funds are coming in and may be calling. Labor & Industries (L&I) clients may be lined up outside the lawyer's office on the days that L&I payments are due. Even so, a lawyer must resist the urge to disburse funds from a deposit before the deposit is collected by the lawyer's bank.

RPC 1.15A(h)(7) says a lawyer "must not disburse funds from a trust account until deposits have cleared the banking process and been collected." That rule can be difficult to follow. Most banks are unable to tell you when a deposit has been collected. The teller may say the "funds are available" or "it looks like the deposit has cleared," but they are usually looking at a screen that shows the deposit was made. If a lawyer makes a deposit and then goes back to the office and looks online, the lawyer may also see that the deposit was posted to the account, but that does not mean the funds have been collected and are in the account ready to be disbursed.

I have had countless lawyers tell me—while explaining an overdraft in their trust account—that the bank said it was all right to go ahead and disburse the funds. But you

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should keep in mind that the bank is not familiar with the RPC requirements. Disbursing funds as soon as they are deposited is a gamble. You are betting that the deposit is going to go through the banking process without any problems, and in most cases you would win that bet. However, the consequences of losing can be catastrophic, and disbursing funds too quickly is not worth the risk. If the \$100,000 deposit fails to be collected for some reason, do you have enough of your own funds to replace that deposit while you try to fix the problem? In the case of a scam, the problem may be unfixable. What if there were no rule requiring you to wait before disbursing funds? Wouldn't you want to wait anyway to protect yourself?

What should lawyers do if they are not able to clearly determine when funds have cleared the banking system and been collected? Determining the status of a deposit should be done on a deposit-by-deposit basis. You should consider the types of deposits that come into your office and establish a policy for how long you wait for each particular type of item to clear; then you should consider each deposit. You may feel more comfortable about a deposit that comes from someone you know and is drawn on a local bank. If you have a feeling that something is a little "off" about a particular deposit, why not wait a day or two longer than you normally would to disburse against that deposit? In most of the cashier check schemes described by Mark Fucile, if the lawyer had only waited a day or two more, he or she would have discovered the scam before disbursing the funds.

Deposits come in all different forms. There are different types of checks, such as those drawn on someone's personal or business account. Credit card deposits may take 2-4 days. (Contrary to what some peo-

ple believe, the money does not appear in the account at the time the card is swiped.) Payments from Labor & Industries are not checks drawn on a bank; they are warrants that are demands on the State Treasury and are payable upon presentment. (You still have to wait for the funds to be collected, which usually occurs the day after being deposited.)

All other manner of payments, such as cashier checks, certified checks, and money orders, must go through the banking system before they can be disbursed. You may want to wait a substantially longer period of time before disbursing funds from these kinds of deposits because of their common use in scams against lawyer trust accounts.

The Oregon State Bar Professional Liability Fund (PLF) website⁶ offers some helpful guidelines that Washington lawyers may want to consider when developing their own procedures related to waiting for deposits to clear before disbursing:⁷

For an ordinary transaction with an established client or known third party, wait three banking days for locally written checks, five banking days for checks written within Oregon, but outside your local area, and ten or more banking days for out-of-state checks. Note, that checks for \$5,000 and over may be held by banks for seven banking days, whether drawn on a local, in-state, or out-of-state bank, therefore allow sufficient time for these checks.

To avoid the growing problem of check scams, wait at least ten banking days before disbursing funds in the following circumstances: (1) the transaction is with a new client or a client you are unsure about; (2) the check is very large; (especially compared with the extent of legal services provided, if the check is a retainer); (3) the check is from an unknown third party; or (4) any aspect of the transaction raises (or should raise) your suspicions. Remember that drafts or other instruments may take longer than ten days to process. To verify that funds have been collected, ask your bank to contact the issuing bank.⁸

EXERCISE PATIENCE

One of the best pieces of advice I can give is to be patient. We understand that clients want their settlement money or L&I payments. We understand that lawyers need to be paid as well. Lawyers should try to manage client expectations about when they will receive their money before deposits come in. A bank may make deposited funds available or say it's all right to disburse those funds, but if something happens and the deposit is not collected, most banking agreements between banks and their customers hold the customer liable for any checks returned as a result. No matter what the bank tells you about the availability of funds, as lawyers you are ultimately responsible for funds you deposit and disburse from your trust accounts. **BN**

NOTES

1. This applies to other legal professionals, such as LLLTs, who may deposit funds into an IOLTA account.
2. Lawyers are required to self-report overdrafts of their trust accounts under Rule for Enforcement of Lawyer Conduct (ELC) 15.4(d).
3. That is why the Rules of Professional Conduct (RPC) require you to maintain client ledgers and reconcile the total of all ledger balances to the reconciled checkbook register. This process reveals whether or not you have enough funds in the trust account.
4. RPC 1.15A, Comment [11] states that a lawyer may enter into a written agreement with their bank where the bank agrees that any uncollected deposits will not be charged back against the trust account. Instead, the bank agrees to charge the uncollectable deposit against a line of credit or other account belonging to the lawyer. The lawyer is still responsible for replacing any funds that were disbursed against the uncollected deposit.
5. RPC 1.15A(h)(8) prohibits lawyers from disbursing funds on behalf of a client that exceed the amount of funds on deposit for that client, and also prohibits using one client's funds on behalf of someone else.
6. www.osbplf.org.
7. Waiting an appropriate amount of time for deposits to clear, such as those periods suggested by the Oregon PLF, is not inconsistent with Washington RPC 1.15A(f), which requires a lawyer to promptly pay funds to clients or third persons who are entitled to receive them.
8. www.osbplf.org/assets/forms/pdfs/Frequently%20Asked%20Trust%20Account%20Questions.pdf.

MORE ONLINE

For more information on available funds and other trust-account issues, review the publication "Managing Client Trust Accounts," which can be found at www.wsba.org/for-legal-professionals/ethics/iolta.

