

FRIDAY, SEPTEMBER 1, 2023

## PERSPECTIVE

## CAALA Las Vegas 2023

## ETHICS

## New frontier for trust accounting

By Erin M. Joyce

In the post-Girardi era, additional scrutiny has been focused on the State Bar for its inexplicable inaction over a period of decades in the face of over 150 complaints, mostly from clients, about mishandling of entrusted funds by an attorney with significant political power. The State Bar's solution to its seemingly deliberate failure to investigate and prosecute colorable complaints of serious trust account violations by Tom Girardi has been to propose tightened regulations on all practicing attorneys in California who handle third party funds, and to conduct random audits or compliance reviews of trust accounts maintained in California financial institutions.

Under Rule of Professional Conduct 1.15, all California attorneys who hold entrusted funds must maintain a trust account in California. Specifically, Rule 1.15(a) provides that "[a]ll funds received or held by a lawyer or law firm for the benefit of a client, or other person\* to whom the lawyer owes a contractual, statutory, or other legal duty, including advances for fees, costs and expenses, shall be deposited in one or more identifiable bank accounts labeled "Trust Account" or words of similar import, maintained in the State of California. ..." The reason for requiring the use of a California trust account is to ensure that the financial institution holding entrusted funds is obligated by stat-

ute to report any insufficient funds activity on the account to the State Bar. *See* Business and Professions Code section 6091.1.

Since the adoption of the current rules, all advanced fees with the exception of flat fees under some limited circumstances, and all advanced costs need to be held in a trust account. And an attorney has the same fiduciary obligation to third parties who have a claim to entrusted funds as that owed to the client. Those fiduciary obligations include the duty to notify the client or their party claimant to the funds within 14 days of the receipt of the funds (Rule 1.15(d)(1), to promptly account in writing to the client or other person for whom the lawyer holds funds or property (Rule 1.15(d)(4), and promptly distribute any funds that the client or third party is entitled to receive (Rule 1.15(d)(7).

Under the revisions to Rule 1.15 ushered in by the adoption of the Client Trust Account Protection Program (CTAPP), there is a rebuttable presumption that a reasonable time for distribution of undisputed funds is 45 days from the receipt of the funds. Rule 1.15(f). An attorney can rebut the presumption by showing there was good cause for not distributing the funds within the 45 day period, or by showing the funds remained in dispute. The new CTAPP revisions also clarified that "promptly" notifying a client or third party of receipt of funds means only two weeks (or 14 days).

CTAPP required all California attorneys to familiarize themselves

with the trust accounting requirements and to take a self-assessment no later than April 3, 2023 (which was an extended deadline for the first year). Attorneys were also required to certify under penalty of perjury that they are in compliance with CTAPP on their State Bar profiles.

California attorneys who did not comply with CTAPP after April 3, 2023 were fined and received notices of the serious risks facing their licenses if they failed to belatedly comply with California Rule of Court 9.8.5. Rule of Court 9.8.5 requires California attorneys to certify annual compliance with CTAPP. As of July 1, 2023, over 1600 California attorneys were enrolled on administrative inactive status because they failed to complete the 12 question self-assessment and the certification by the extended deadline of June 30, 2023.

These administrative suspensions were solely related to the failure to complete the certification and self-assessment. To date, the State Bar has not commenced random audits, or compliance reviews. As initially conceived, the compliance reviews would start after all California attorneys were required to certify compliance. However, Leah Wilson, the State Bar's Executive Director, reported during an open forum in May 2023 that random audits will now be delayed until after the next compliance period, or after Feb. 1, 2024.

So what do California attorneys need to do now to be ready to withstand the coming audits? All California attorneys need to main-

tain the following records for each trust account they have: (1) an account journal which identifies the date, amount and client affected by each debit or credit, (2) a client ledger card for each client whose funds are deposited in the trust account, (3) all bank statements and canceled checks for each trust account; and (4) each monthly reconciliation, tying the transactions on the account journal to the bank statement. The explainable differences need to be tracked, such as

**Erin M. Joyce** is an expert in legal ethics and has extensive experience in State Bar investigations and disciplinary proceedings, as well as 25 years of civil litigation experience. She is the founder of Erin Joyce Law, PC. She is also one of the speakers on the Ethics Panel at the Consumer Attorneys Association of Los Angeles (CAALA) conference, Friday, Sept. 1.



when the account journal reflects a check issued in a given month to a client, and the bank statement which does not yet reflect that check since it has not been negotiated by the time the statement was issued by the bank.

It is also imperative to keep records of all deposits, meaning copies of all deposit slips and deposited checks. These documents are needed to maintain a proper account journal. Best practices also dictate that the attorney copy all checks sent out to clients and third parties, so in the event the checks do not clear the account in a few months, the attorney can quickly follow up to put a stop payment on such checks and re-

issue them. Under the comments adopted for Rule 1.15, attorneys are cautioned to diligently resolve disputes as to entrusted funds and will be required to establish good cause why funds remained in the account after checks were issued and perhaps lost in the mail. Attorneys need to stay on top of the outstanding checks to ensure they are negotiated promptly.

Attorneys also need to be prepared to document that they notified all claimants to entrusted funds within 14 days of receipt. This notice needs to go out not only to the client, but also all medical lien holders or even litigation funding loan companies, in a personal injury matter for instance.

This two week notice requirement means personal injury firms will need additional dedicated staff in the lien negotiation department to document these notices. But failure to document the timely notice could open the attorney to significant discipline, since trust account violations are heavily weighted under the Standards for Imposition of Discipline in Attorney Misconduct Cases, which are the sentencing guidelines in State Bar practice.

Attorneys will also need to document efforts to negotiate liens, both to show that funds deposited are “disputed” and to establish good cause why all funds from each settlement are not distributed within 45 days. Attorneys are chal-

lenged to diligently resolve liens and to distribute all entrusted funds in the approximately six week window.

The best approach for attorneys is to use a commercially available accounting software program, like QuickBooks Online or Quicken, to ensure that manual errors are avoided. Excel is another alternative for a trust account which is not too busy. An attorney’s obligation to comply with CTAPP is a non-delegable duty. Attorneys can hire accounting professionals or train in-house staff to complete the monthly reconciliations, but they should always remember the attorney is ultimately responsible to ensure the accuracy of the CTAPP reporting.