NEW YORK STATE BAR ASSOCIATION

Journal

MAY 2013
VOL. 85 | NO. 4

Demystifying ESQrow Ethics

by Devika Kewalramani, Jason Canales and Michelle Cox

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"Escrow" rhymes with "death row." This is a handy way to remember how carefully a New York lawyer should treat an escrow account. Unlike the American Bar Association Model Rules of Professional Conduct (the ABA Model Rules) and rules in other states, New York is the only state whose ethics rules specifically prescribe disciplinary action for mishandling escrow accounts.[1] In addition, New York lawyers are required to certify their familiarity with the escrow funds rule, Rule 1.15, when they biennially register to practice. Clearly, when it comes to escrow funds held by a lawyer, New York means business.

Yet, despite these specific warnings, many lawyers still run afoul of Rule 1.15. Some violations are deliberate and flagrant, but others are mere mistakes – subtle and unintentional. Irrespective of intent, however, lawyers who violate the escrow rules are exposed to censure, suspension or disbarment.

This article reviews some common ideas about what constitutes ethical conduct in handling escrow funds and suggests best practices to avoid violations.

Escrow Ethics: True or False?

As long as lawyers do not commingle client funds, they have fully complied with the escrow rules.

False: Implicit in the attorney-client relationship is a fiduciary and ethical obligation to the client to properly handle client and third-party funds by establishing and maintaining an attorney trust or escrow account. This duty is governed by specific ethics rules. Avoiding the commingling of client funds is only one of the many duties under those rules.

New York's Rule 1.15 contains strict and strongly enforced rules for escrow accounts. It has a long and detailed list of do's and don'ts. In addition to prohibiting commingling client or third-party funds with the lawyers' funds (or, of course, misappropriating them), it requires:

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- separate and specially designated accounts for escrow funds;
- notification to a client or third person upon the receipt of escrow funds;
- prompt payment from escrow accounts on proper request;
- complete and accurate record-keeping procedures;
- disbursements to be made only by New York-admitted lawyers; and
- account withdrawals to be made only to a named payee and not to cash.

he lacked venal intent.[8] Similarly, in *In re Tepper,* the First Department found that a two-year suspension was appropriate for "careless and nonvenal invasion of client funds for personal and business uses."[9]

One example of how unintentional conversion can occur is when multiple client or third-party funds are held together in a single master escrow account. Many lawyers maintain multi-client escrow accounts where the funds of different clients or third parties are commingled. Although Rule 1.15 explicitly prohibits commingling the lawyer's funds with client or third-party funds,[10] the

Even if a lawyer is not directly responsible for the mishandling of escrow funds, he or she may still be held accountable.

The Preamble to the Rules states that failing to comply with a rule is a "basis for invoking the disciplinary process."[2] This warning statement is repeated in the final section of Rule 1.15. Rule 1.15(j) cautions: "A lawyer who does not maintain and keep the accounts and records as specified and required by this Rule, or who does not produce any such records pursuant to this Rule, shall be deemed in violation of these Rules and shall be subject to disciplinary proceedings."[3]

Both intentional and unintentional conversion of client funds can result in disciplinary charges.

True: When a lawyer acts with the motive or intent to convert client escrow funds and deliberately withdraws or uses such funds without the client's permission or authority, courts refer to such conduct as acting with "venal" intent.[4] The fact that the lawyer planned to return the funds does not mitigate the offense. In *In re Birnbaum*, the Appellate Division, First Department, observed, "This Court has consistently found that '[a]bsent extremely unusual mitigating circumstances,' an attorney who has intentionally misappropriated client funds is presumptively unfit to practice law and that such conduct warrants disbarment."[5]

Repayment of converted escrow funds has not been considered an "extremely unusual mitigating circumstance" and "does not excuse the wrongful conduct."[6] As stated by the Appellate Division, First Department, in *In re Baumgarten*, "[t]he fact that [a lawyer] intended to replenish the funds he utilized and did in fact pay back his clients is not relevant to the issue whether he acted with venal intent. Attorneys, such as respondent, who have intentionally converted client funds, must be disbarred."[7]

Unintentional conversion, referred to as "nonvenal," can still result in disciplinary charges. In *In re Altomerianos,* the Appellate Division, First Department, found a two-year suspension was warranted where an attorney commingled and converted escrow funds even though rule does not require the lawyer to segregate funds of multiple clients or third parties. However, conversion of escrow funds in such joint accounts can take place if a withdrawal is made for the benefit of a client whose deposits have not yet cleared the account. In such a case, the withdrawn amount comes from funds that had been deposited on behalf of other clients or third parties. In *In re Joyce*, the Appellate Division, Second Department, suspended an attorney for three years after he issued checks from his escrow account in excess of the amount available for the client and in advance of a deposit which was to be the source of the funds, causing the checks to be cleared against other client or third-party funds.[11]

Even innocent mistakes in handling an attorney's escrow account may subject a lawyer to disciplinary proceedings. For instance, a lawyer may innocently issue a check from the attorney trust or escrow account to "cash," but this violates the rule because checks drawn on an attorney escrow account must be made payable to a named payee.[12] Although such errors can be innocuous, courts have repeatedly held that acting without venality is merely a mitigating factor in determining sanctions, but not probative of whether the lawyer has committed an ethical violation.[13]

No harm, no foul!

False: Although in violating the escrow rules a lawyer may not have harmed his client or a third person, the lawyer may still be in trouble. Courts have held that, "[i]n determining an appropriate measure of discipline to impose, we have considered the respondent's alleged lack of venal intent, the fact that he did not use the escrow funds for his own benefit, *and the lack of ultimate harm to any clients or third parties*. The [attorney] is, nevertheless, guilty of gross mismanagement of his escrow fund and failing to supervise and review his escrow account."[14]

In *In re Francis,* the grievance committee filed charges against an attorney for commingling personal funds with client escrow funds and for failing to maintain an escrow

ledger after a check drawn on his escrow account was dishonored.[15] The attorney represented mainly poor and unemployed clients and in attempting to help his clients would make mortgage and application fee payments on their behalf. The attorney also deposited personal money into the account to provide a cushion for these withdrawals. After making payments and returning fees to clients in need of money, there was a discrepancy in the escrow account which resulted in a dishonored check. Although the attorney never converted money for personal use and was helping those less fortunate, the Appellate Division, First Department, found that his "commendable intentions did not excuse his failure to familiarize himself with the rules."[16] The attorney was censured for nonvenal escrow violations under then-Disciplinary Rule 9-102(a) and (b) (the pre-2009 escrow fund rule, which was substantially similar to the current rule, Rule 1.15).[17]

Rule 1.15 covers only client funds held in escrow, not funds of third persons held in escrow.

False: Rule 1.15 is applicable both to funds held in escrow for clients and funds held in escrow for third persons. The account establishment, maintenance, segregation, notification and recordkeeping duties for funds held in escrow for clients also apply to funds held in escrow for third persons.[18] Holding the funds of a third party in an attorney escrow account creates a fiduciary duty to those parties as well as to clients.

If one partner in a firm violates an escrow fund ethics rule, the other partners are not responsible.

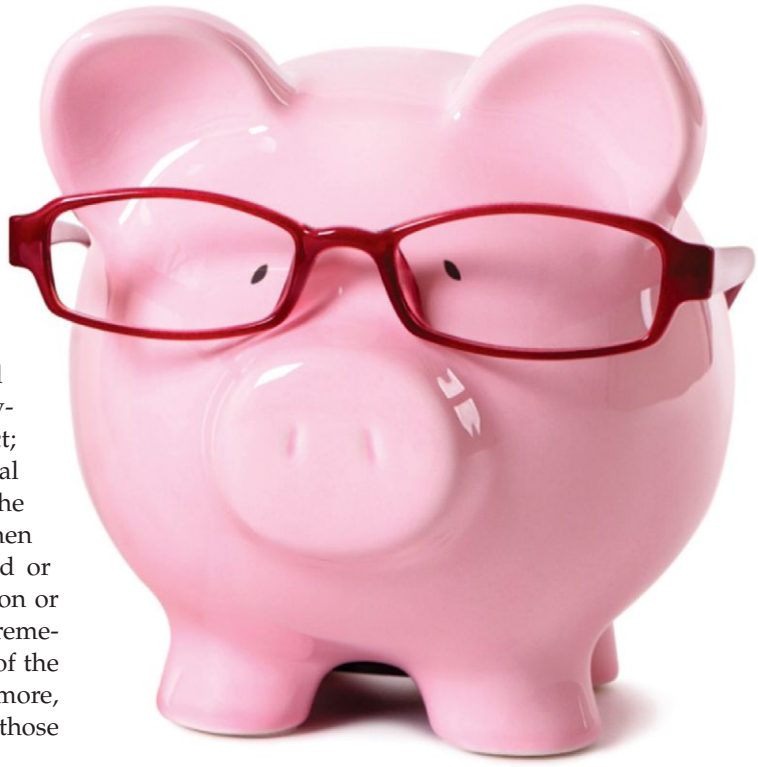
False. Even if a lawyer is not directly responsible for the mishandling of escrow funds, he or she may still be held accountable under Rule 5.1, which is titled "Responsibilities of Law Firms, Partners, Managers and Supervisory Lawyers."

Rule 5.1(a)–(c) requires law firms and lawyers with management responsibility and direct supervisory authority over other firm lawyers to make reasonable efforts to ensure that all lawyers in the firm conform to the Rules and to adequately supervise the work of partners and associates, as appropriate. Rule 5.1(d) imposes personal responsibility on the lawyer for an ethical violation by another lawyer if the supervising lawyer (1) orders, directs or ratifies the specific conduct; or (2) is a partner, possesses comparable managerial responsibility or has supervisory authority over the other lawyer and (i) knows of such conduct when it could be prevented or its consequences avoided or mitigated but fails to take reasonable remedial action or (ii) should know of the conduct so that reasonable remedial action could be taken when the consequences of the conduct could be avoided or mitigated.[19] Furthermore, New York Rules, unlike the ABA Model Rules and those of some other states, also place responsibility on the law firm itself for the unethical conduct of its lawyers.

In *In re Cardoso*, an attorney was found guilty of professional misconduct for failing to review for irregularities the financial and bookkeeping records of his firm after his partner deposited and withdrew personal funds into the attorney escrow account for personal use, including making payments to himself and to his brother. After discovering the improprieties, the attorney dissolved the partnership and contacted the grievance committee.[20] The Appellate Division, Second Department, held that, as a partner in the law firm, he had "a responsibility to oversee his partner's handling of the escrow account."[21] The absence of venal intent does not excuse the failure to properly monitor an escrow account, although it can be a mitigating factor in the severity of the sanction imposed.[22]

If lawyers delegate their fiduciary duties to suitably qualified non-lawyers, such as bookkeepers or paralegals, and a mistake is made, they will not be held accountable.

False. Similar to Rule 5.1, which imposes ethical responsibility for the conduct of other lawyers, Rule 5.3 imposes ethical responsibility for the conduct of non-lawyers ("Lawyer's Responsibility for Conduct of Nonlawyers"). Rule 5.3(a) requires law firms and lawyers with direct supervisory authority to adequately supervise the work of non-lawyers. Its structure parallels that of Rule 5.1: Rule 5.3(b) imposes personal responsibility on the



lawyer for a violation of the Rules committed by a non-lawyer retained by or associated with the lawyer if the lawyer (1) orders, directs or ratifies the specific conduct or (2) is a partner, possesses comparable managerial responsibility or has supervisory authority over the non-lawyer and (i) knows of such conduct when it could be prevented or its consequences avoided or mitigated but fails to take reasonable remedial action or (ii) should know of the conduct so that reasonable remedial action could be taken when the consequences of the conduct could be avoided or mitigated.[23]

The lawyer's fiduciary and ethical duty to clients and third parties to safeguard escrow funds cannot be delegated away. While lawyers may have non-legal personnel deal with escrow funds, failing adequately to supervise the non-lawyers is in itself a violation of the Rules,[24] and any misuse or conversion of escrow funds by the non-lawyers may be deemed a breach of that duty by the lawyer. By way of example, in *In re Iaquinta-Snigur,* the Appellate Division, Second Department, suspended an attorney for three years for, among other things, "[failing] to adequately supervise, oversee, inspect, or examine the foregoing work of her nonlawyer staff during the aforesaid period, thereby contributing to numerous account errors, anomalies, and fiduciary improprieties that occurred in connection with that account during that time."[25]

Merely giving access to a lawyer's escrow account to non-lawyers is not prohibited. Only a lawyer may control and be a signatory to an escrow account, but a New York State Bar Opinion concluded that a paralegal, under the close supervision of an attorney, may properly be delegated the use of a signature stamp to execute transactions from an escrow account.[26] However, the attorney can be held responsible for inadequate supervision in any wrongdoing committed by the subordinate.

In *In re Galasso*, the Court of Appeals affirmed sanctions for a lawyer's failure to monitor and properly supervise his non-lawyer brother, who was the bookkeeper for the law practice. The brother converted funds from an escrow account after altering the account application to include himself as a signatory.[27] Finding that the lawyer "ceded an unacceptable level of control"[28] over the account to a non-lawyer, the Court held that the lawyer thereby created the opportunity for misuse of the escrow funds and violated the Rules.

The most prudent way to prevent ethical violations resulting from non-lawyer access to escrow funds is diligent lawyer supervision, monitoring and management.

Escrow violations arise only in small or solo law practices and lead only to disciplinary charges.

False: Law firms of all sizes are at risk. Law firms that have transactional or commercial practices, such as real estate, may be at greater risk of an escrow violation because they routinely hold funds belonging to the client or others. In addition, the consequences can go beyond disciplinary sanctions. Misappropriation of client escrow funds can result in civil liability to the client; even criminal charges are possible.[29]

Best Practices

Segregate, Segregate, Segregate

Although the Rules do not require that attorneys maintain separate escrow accounts for each client and permit client and third-party funds to be held in a single master escrow account, segregating escrow funds into separate accounts ensures that no client's funds are used for the benefit of another client. If the lawyer is unable to open separate accounts for each client or third party, the lawyer should keep scrupulous and detailed records of deposits into and withdrawals from the master escrow account.

Records, Records, Records

Key to avoiding escrow issues is implementing a standardized recordkeeping process. Lawyers should keep detailed records of dates of deposits and withdrawals to ensure that funds withdrawn are already available. Although Rule 1.15 requires only notification of receipt of funds, lawyers may want to make it a practice to give written notification to the client of payments or disbursements being made from the escrow account on the client's behalf.

Another good practice is to regularly reconcile escrow account records and monitor accounts, particularly if a lawyer has delegated this access or control over the funds to another lawyer or non-lawyer employee. In California, for example, lawyers are required to keep records of deposits, disbursements, sources of funds, balances of bank accounts, bank statements and canceled checks.[30] Each month, lawyers are required to reconcile these records with one another. Although monthly reconciliation is not specifically required in New York, a monthly reconciliation of records associated with the lawyer escrow accounts may help prevent inadvertent mistakes and also assist in promptly identifying any mishaps so that they can be quickly remedied. In addition, lawyers should have their records periodically audited by outside accountants to make sure that their records are in order, thereby reducing the possibility of violating Rule 1.15.

Supervise, Supervise, Supervise

As noted above, while a non-lawyer is prohibited from being a signatory on an attorney escrow account, non-lawyers may be permitted to stamp the lawyer's signature. To reduce the likelihood of misuse or abuse of the signature stamp, lawyers should restrict or limit access to the signature stamp, providing access only upon review or approval of the documentation requiring the stamp. Providing periodic training for non-lawyers can also help reduce or avoid mistakes in the proper handling of escrow funds and accounts.

Finally, when it comes to your escrow accounts, do not trust anyone but yourself. As emphasized by the Court of Appeals in *Galasso*, "[i]t is the ethical responsibility of the attorney – not the bookkeeper, the office manager or the accountant – to safeguard client funds."[31] Attorneys should implement appropriate practices and procedures to ensure that lawyers and non-lawyers who have access to their firm's escrow account are always acting in compliance with the Rules.

Conclusion: Escrow Accounts Require Continual Attention

Dealing with attorney escrow accounts requires complete honesty, but complete honesty is not enough. Care must be taken in the structure and handling of escrow accounts, including active supervision and monitoring if escrow duties are delegated. Anything less is inviting serious trouble. ■

1. New York Rules of Professional Conduct Rule 1.15(j) (the Rules or NYRPC).
2. NYRPC Preamble.
3. NYRPC Rule 1.15(j).
4. *In re Squitieri*, 88 A.D.3d 380, 382 (1st Dep't 2011).
5. *In re Birnbaum*, 308 A.D.2d 180, 183 (1st Dep't 2003).
6. *Id.* (citing *In re Landau*, 180 A.D.2d 257, 258 (1st Dep't 1992) ("Ultimate repayment of the misappropriated funds does not excuse the wrongful conduct.").
7. *In re Baumgarten*, 236 A.D.2d 30, 34 (1st Dep't 1997) (citing *In re Glazer*, 218 A.D.2d 411, 413 (1st Dep't 1996)). *See also In re Kirschenbaum*, 29 A.D.3d 96, 101 (1st Dep't 2006) ("the fact that he intended to and did in fact repay the funds, does not negate venal intent").
8. *In re Altomerianos*, 559 N.Y.S.2d 712, 717 (1st Dep't 1990).
9. *In re Tepper*, 286 A.D.2d 79, 81 (1st Dep't 2001).
10. NYRPC Rule 1.15(a).
11. *In re Joyce*, 236 A.D.2d 116 (2d Dep't 1997).
12. *In re Abbatine*, 263 A.D.2d 228, 231 (2d Dep't 1999).
13. *See In re Galasso*, 19 N.Y.3d 688, 694 (2012).
14. *In re Joyce*, 236 A.D.2d at 121 (emphasis added). *See also In re Klugerman*, 189 A.D.2d 284 (1st Dep't 1993).
15. *In re Francis*, 78 A.D.3d 106, 107 (1st Dep't 2010).
16. *Id.* at 109.
17. Roy Simon, *Comparing the New NY Rules of Professional Conduct to the NY Code of Professional Responsibility* (2009) *at* http://www.nysba.org/Content/NavigationMenu/ForAttorneys/ProfessionalStandardsforAttorneys/CorrelationtableofnewNYrules.pdf.
18. *See* NYRPC Rule 1.15 (c), (d).
19. NYRPC Rule 5.1.
20. *In re Cardoso*, 152 A.D.2d 157 (2d Dep't 1989).
21. *Id.* at 159.
22. *In re White*, 9 A.D.3d 163, 165 (2d Dep't 2004).
23. NYRPC Rule 5.3.
24. *Id.*
25. *In re Iaquinta-Snigur*, 30 A.D.3d 67, 76 (2d Dep't 2006).
26. NY State Bar Ass'n, NY Comm. on Prof'l Ethics, Op. 693 (Aug. 22, 1997).
27. *See In re Galasso*, 19 N.Y.3d 688 (2012).
28. *Id.* at 694.
29. Ashley Post, *Crowell & Moring Faces Third Lawsuit Tied to Former Employee's Theft*, Inside Counsel, Nov. 18, 2011, http://www.insidecounsel.com/2011/11/18/crowell-moring-faces-third-lawsuit-tied-to-former; *see also* Leigh Jones, *Crowell & Moring Settles $5.5 Mln Suit Involving Fugitive Lawyer*, Thomson Reuter, http://newsandinsight.thomsonreuters.com/Legal/News/2011/12_-_December/Crowell___Moring_settles_$5_5_mln_suit_involving_fugitive_lawyer/.
30. *See* Cal. Rules of Prof'l Conduct R. 4-100 Standard (d).
31. *Galasso*, 19 N.Y.3d at 694.

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