

MEMORANDUM

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TO: Members of the Representative Assembly

FROM: The Client Protection Fund Standing Committee

RE: Proposed Rule for Trust Account Overdraft Notification

DATE: July 17, 2006

306 Townsend Street
Michael Franck Building
Lansing, MI
48933-2083

You may recall that at the last Representative Assembly meeting, members of the Client Protection Fund Standing Committee gave an informational presentation regarding the need for a trust account overdraft notification rule and indicated that the Committee would be submitting a proposed rule for consideration at the September meeting. Attached, as Exhibit A is the proposed rule, new MRPC 1.15A.

What the Representative Assembly is Being Asked to Do

The Committee requests action by the Representative Assembly as follows:

"The Representative Assembly approves the proposed Trust Account Overdraft Notification rule, MRPC 1.15A, and authorizes the State Bar of Michigan to make any subsequent editorial, clerical or technical language changes to the proposed Rule and comments that may assist in effecting the intent of the proposal after discussion with Michigan financial institutions and others and prior to submitting the Rule to the Michigan Supreme Court."

While the first step for this proposal naturally is the Representative Assembly because it fundamentally involves the legal profession's efforts to protect client funds, the next step must include input from Michigan bankers to verify that the technical terminology and the process are described in a manner that is workable, eases bank administration and actually effects the intent of the rule. The Committee attempted to draft the rule correctly for these purposes but thinks it is prudent for the Representative Assembly to authorize subsequent technical or editorial language changes in case discussion with bankers or others warrant changes, e.g. using terminology that makes clear that electronic transactions are covered by the Rule.

How The Rule Was Drafted

The proposed rule is the result of a broad-based collaboration among members of the Client Protection Fund Standing Committee, representatives of the

Michigan State Bar Foundation, and staff from the Attorney Grievance Commission and the Attorney Discipline Board, all of who contributed their insight and expertise. The collaboration brings to the table those people with special expertise and experience, to craft a rule that would avoid unintended consequences or issues, and that would be acceptable to all constituencies involved – the practicing bar, the banking industry and the discipline agencies.

The drafting committee looked at rules from other states, conducted research about other states' programs and talked with colleagues from other states about operational issues. The drafting committee held three meetings to discuss, debate, and draft the rule.

How The Rule Works

Overdraft notification programs are not intended to result in the discipline of every lawyer who overdraws a trust account. Lawyers and financial institutions may make innocent errors and the rule contains a mechanism to identify these situations without adverse impact on the lawyers. The rule is structured to trigger an “early warning” of improprieties so that harm to the public can be avoided. The experience of other states that have adopted trust account overdraft notification (which is discussed more fully below) confirms that the rule functions as it is designed i.e., not as a mechanism for drawing attorneys into the discipline system but rather as a way to spot patterns or indications of abuse.

The proposed rule states that attorneys may place client trust accounts only with financial institutions that are “approved by the State Bar of Michigan.” To apply for approval, a financial institution must enter into an agreement with the State Bar of Michigan to notify the Attorney Grievance Commission and the trust account holder if any properly payable instrument is presented against a lawyer trust account containing insufficient funds, whether or not the instrument is honored and irrespective of any overdraft protection or other similar privileges that may attach to such account. A sample agreement between the State Bar of Michigan and the financial institutions is attached as Exhibit B. This draft agreement is not being offered for approval by the Representative Assembly, but to illustrate the type of agreement the State Bar would develop under proposed MRPC 1.15A (B) which authorizes the agreement to be in a form provided by the State Bar.

Once notice is given by the financial institutions, a lawyer who receives notification that any instrument presented against the trust account was presented against insufficient funds must contact the Attorney Grievance Commission in writing within twenty-one (21) days of issuance of the notice with a full explanation of the cause of the overdraft.

What Impact The Rule Has On Financial Institutions

After a one-time set up, which should allow automated electronic systems to be used to meet the reporting requirements; Michigan financial institutions should be able to easily meet the requirements of the Rule. In fact, a number of Michigan financial institutions may not have to do much to set up their systems as they already have processes in place for their use due to having affiliated branches in other states that already have similar trust account overdraft notification procedures. For others, start-up administration could include assuring that their computer systems can flag all current accounts that are trust accounts and can trigger the generation of the reports when an overdraft occurs. Financial institutions have sophisticated technology that already flag accounts for any number of purposes. While this should be easy for all banks to do, we need to realize that it may take some time to initially set up. It will also take some time for Michigan lawyers to assure that their current IOLTA and other trust accounts are identified at their banks as "trust accounts," as required by paragraph A.2. of the proposed Rule. The State Bar will provide education to lawyers to help them do this. Without identifying the accounts as trust accounts, banks will not be able to flag them for overdraft reporting to the Attorney Grievance Commission.

The financial institution must provide the notice to the Attorney Grievance Commission and the lawyer within five banking days of the date the item was paid or returned unpaid. Generally, financial institutions provide notice even sooner to the account holder. Also, financial institutions may use a copy of the "notice of dishonor" they customarily send to depositors in the event of a dishonored instrument to notify the Attorney Grievance Commission. Financial institutions must also provide notice when a properly payable instrument is presented against insufficient funds, even though the instrument is honored.

Of course, financial institutions will have expenses associated with providing these reports, which they may recover through charging the lawyer a reasonable fee for the reporting required when overdraft notification is triggered. Presently, banks do charge a fee for overdrafts to their depositors. Charges for providing the reports and records may not be charged against, principal, interest or dividends earned on trust accounts, including IOLTA accounts. To ease the administration of collecting the charges, banks may make an arrangement with the lawyer trust account holder to deduct the fees from other non-trust accounts the lawyer may have at that institution. Generally, law firms have a business account at the same banks as their trust account(s). Again, banks already have systems in place to link accounts for purposes such as paying fees. Also, under MPRC 1.15, lawyers may place so much of their own funds into the trust account as are needed to pay fees. Or, banks may choose to bill law firms for these costs.

Notification is still required in situations where the trust account carries overdraft protection or other similar privileges. The sample financial institutions agreement at Exhibit B notes that the financial institution acknowledges that trust account funds cannot be used as overdraft protection for any other account. The Rule comments also reiterate this for lawyers.

The proposed Rule provides that attorneys are deemed to consent to the reporting requirements. This is to assist banks in knowing that they may freely provide the required information to the Attorney Grievance Commission. Should an overdraft notification result in an investigation that requires additional information from the financial institution, the Attorney Grievance Commission will need to use the same methods they use now to request it, such as written consent by the account holder or subpoenas.

The rule calls for the State Bar of Michigan to establish guidelines for the operational procedure to effectuate this rule, including the process of approval and termination of approved status for financial institutions. The guidelines will address under what circumstances approved status will be withdrawn; for example, approved status may be revoked where the institution demonstrates a pattern of neglect or showing of bad faith. Another issue to be addressed is the timing and manner in which lawyers are notified when their financial institution's approved status is terminated (see possible time frame noted in Exhibit B).

As these operational guidelines directly impact and implicate financial institutions methods of procedure, which are increasingly, if not exclusively, electronic in nature, the guidelines will be drafted after consultation with representatives of the financial institutions industry. This will ensure that the guidelines meet both the needs of the legal profession while making reporting as easy as possible for the financial institutions. As noted above, the Committee will also discuss the language of the proposed Rule and its comments with Michigan bankers should the Representative Assembly authorize the State Bar to make subsequent technical or editorial language changes that will help effect the intent of the Rule.

Why A Rule Is Needed

In the past four years the State Bar of Michigan Client Protection Fund has paid \$1,028,418 in claims. Sixty-nine percent of these claims, or \$705,000 is attributable to the actions of nine attorneys from nine different counties throughout the Lower Peninsula.

Approximately thirty-six jurisdictions have implemented trust account overdraft notification programs [Exhibit C] and all jurisdictions report that the programs have been very successful. New Jersey reports that since the program began in 1985, it has averaged three hundred and twenty-five (325) attorney overdrafts per year. The New Jersey Supreme Court has disciplined eighty-five (85) attorneys for financial misconduct that was discovered solely through overdraft notification. Fifty of the eighty-five attorneys were disbarred, approximately 59%. The balance were suspended, reprimanded or admonished.

The New York Fund reports that from 1993 to February 28, 2006, the Fund has processed over 6,465 bounced check reports with a total face amount in excess of

\$174.2 million. The reports have identified upwards of 145 lawyers who had misused escrow funds.

As reported by the New Jersey Law Journal, a New Jersey lawyer was suspended from practice in the face of evidence provided by the bank indicating that the lawyer had been using client trust funds to fuel a gambling addiction.

Pennsylvania reports that it received 225 overdraft notices during the 2004-2005 fiscal year, which resulted in 26 overdraft notices being referred to the Office of Disciplinary Counsel for further inquiry. The remaining 190 overdraft notices were reviewed, dismissed with a satisfactory explanation, and scheduled for destruction 6 months thereafter.

For fiscal year 2005, Maryland received 109 overdraft notifications. Twenty four were bank error; fifty-eight were resolved because there was a proper deposit to the wrong account, a late deposit, internal fraud, a check drawn for an incorrect amount, a deposit which had not yet cleared, an error on an endorsement or death of the attorney-maker. Twenty-four overdrafts warranted disciplinary action. Three were still pending at the time of the April Representative Assembly meeting.

Pennsylvania reports an incident where \$100 overdraft led to the discovery that a lawyer had been steadily misappropriating from estates, for a total loss in excess of 1.5 million, and was ultimately suspended from the practice of law.

From 1991-2006, Minnesota's trust account overdraft notification program has resulted in 85 private disciplines (admonitions or private probations), two transfers to disability status, 17 public reprimands and probation, 35 suspensions and 14 disbarments.

The Michigan Attorney Discipline Board reports that of the 110 orders of public discipline issued in 2005, 9 (8%) involved an attorney's misappropriation or other mishandling of client funds. In 2004, 14 (12%) of the 120 discipline orders involved misappropriation or other improper handling of funds. That year, the 9 Michigan attorneys disbarred for misappropriation of funds were ordered to pay restitution to their victimized clients of over \$220,000. (This was in addition to the \$668,434 in restitution ordered with the disbarment of an attorney who had embezzled from conservator estates entrusted to him.)

In many discipline cases ending in a finding that the attorney has mishandled, misplaced or sometimes simply stolen client funds, problems involving the attorney's trust account are brought to light only as the result of an investigation triggered by a seemingly unrelated client complaint. For example, a client's request for investigation may allege only that there has been a break down in communication. Subsequent investigation by the Grievance Administrator, however, may call the attorney's trust account practices into question and, in a few cases, may uncover outright theft. The experience of other states with such a rule demonstrates that, in most cases, the dishonored check written on a trust account was the result of bank error or inadvertent clerical error. Their experience also teaches, however, that overdraft

notification invariably leads to the discovery of some cases of embezzlement or grossly negligent handling of funds which would have otherwise gone unreported. In one sense, Michigan's 36,000 lawyers can be encouraged that only a handful of attorneys are disciplined each year for offenses involving client funds. Sadly, the statistics from other jurisdictions establish that, in the absence of the proposed rule, additional acts of misappropriation may remain undetected.

Why You Should Care

The legal profession is one of the few remaining professions enjoying the privilege of self-regulation. If the profession fails to deal with our "bad apples" and give the public a reason to be confident in the legal profession, we run the risk that, like other professions, a taxpayer sponsored, state agency will be constructed to regulate the profession. Dealing with the bad apples of the profession is a responsibility that comes with having the privilege to practice law.

We as Michigan lawyers cannot tell Michigan citizens that we oppose a program that would identify lawyers who may be stealing client funds, when thirty-six other states have instituted these programs that have successfully prevented the public from being victimized.

Who to Contact with Questions and Comments

Should you have questions or comments, you can e-mail them to voice@mail.michbar.org, or contact staff counsel to the Client Protection Fund Standing Committee, Victoria Kremski, at 517-346-6310 or the Client Protection Fund Administrator, Robin Lawnichak, at 517-346-6379.

Respectfully submitted,

Handwritten signature of L. Fallasha Erwin in cursive script, with the initials "PPE" written below the name.

L. Fallasha Erwin
Chairperson, Client Protection Fund Standing Committee

Proposed Michigan Rule of Professional Conduct 1.15A (new)

1.15A TRUST ACCOUNT OVERDRAFT NOTIFICATION

A. Scope. Lawyers who practice law in this jurisdiction shall deposit all funds held in trust in accordance with Rule 1.15. Funds held in trust include funds held in any fiduciary capacity in connection with a representation, whether as trustee, agent, guardian, executor or otherwise.

1. "Lawyer" includes a law firm or other organization with which a lawyer is professionally associated.
2. Lawyers shall clearly identify such accounts as "trust" or "escrow" accounts, referred to herein as "trust accounts," including informing the depository institution of the purpose and identity of the account.

B. Overdraft Notification Agreement Required. In addition to meeting the requirements of Rule 1.15, each bank, credit union, savings and loan association, or open end investment company registered with the Securities and Exchange Commission, (hereinafter "financial institution") referred to in Rule 1.15 must be approved by the State Bar of Michigan in order to serve as a depository for lawyer trust accounts. To apply for approval, financial institutions must file with the State Bar of Michigan a signed agreement, in a form provided by the State Bar of Michigan, that it will submit the reports required in paragraph D of this rule to the Attorney Grievance Commission and the trust account holder if any properly payable instrument is presented against a lawyer trust account containing insufficient funds, whether or not the instrument is honored and irrespective of any overdraft protection or similar privileges that may attach to such account. The agreement must apply to all branches of the financial institution and cannot be cancelled except on ninety (90) days notice in writing to the State Bar of Michigan. Upon cancellation or termination of the agreement, the financial institution must agree to notify all holders of trust accounts subject to the provisions of this rule at least sixty (60) days prior to termination of approved status that the financial institution will no longer be approved to hold such trust accounts.

C. The State Bar of Michigan shall establish guidelines regarding the process of approving and terminating "approved status" for financial institutions, and for other operational procedures, to effectuate this rule. The State Bar of Michigan shall periodically publish a list of approved financial institutions. No trust account shall be maintained in any financial institution that has not been so approved. Approved status under this Rule does not substitute for "eligible financial institution" status under Rule 1.15.

D. Overdraft Reports. The overdraft notification agreement must provide that all reports made by the financial institution contain the following information in the form prescribed by the State Bar of Michigan:

- (a) the identity of financial institution

- (b) the identity of the lawyer or the law firm
- (c) the account number
- (d) a copy of the instrument
- (e) the amount of overdraft and date created and either:
 - 1) the amount of the returned instrument(s) and the date returned, or
 - 2) date of presentation for payment and the date paid

The financial institution must provide the information required by the notification agreement within five banking days of the date the item(s) was paid or returned unpaid.

E. Costs. Nothing in these rules precludes a financial institution from charging a particular lawyer or law firm for the reasonable cost of providing the reports and records required by this rule, but those costs may not be charged against principal, interest or dividends earned on trust accounts, including earnings on IOLTA accounts payable to the Michigan State Bar Foundation under Rule 1.15. Such costs, if charged, shall not be borne by clients.

F. Notification by Lawyers. Every lawyer who receives notification that any instrument presented against the trust account was presented against insufficient funds, whether or not the instrument was honored, shall provide the Attorney Grievance Commission, in writing, within 21 days of issuance of such notification, a full explanation of the cause of the overdraft and how it was corrected.

G. Every lawyer practicing or admitted to practice in this jurisdiction shall, as a condition thereof, be conclusively deemed to have consented to the requirements mandated by this rule.

Comments:

The overdraft notification provision is not intended to result in the discipline of every lawyer who overdraws a trust account. The lawyer must correct and explain overdrafts. The provision intends to provide an early warning of improprieties so that corrective action may be taken.

Automatic reporting of all overdrafts makes notification by a financial institution an administratively simple matter. An institution which receives an instrument for payment against insufficient funds need not evaluate whether the circumstances require that notification be given; it merely provides notices. In the case of a dishonored instrument, the financial institution may submit a copy of the dishonored instrument and a copy of the notice of dishonor it sends to the account holder to the Attorney Grievance

Commission if the notice of dishonor contains the information specified at paragraph D of this Rule, so the Attorney Grievance Commission may determine whether further action is warranted.

It is suggested that the financial institution directly bill the attorney for the costs of providing the reports and records required by this rule or that the attorney consent to the deduction of these charges from the attorney's business account held at the financial institution.

Notification is still required in situations where the trust account carries overdraft protection, either through a line of credit or through a direct link with the attorney's business account. Of course, lawyers may not use trust account funds as overdraft protection on any other account.

Approved status under this Rule does not incorporate "Eligible financial institution" status under Rule 1.15 and the Michigan Supreme Court approved Attorney IOLTA Guidelines which have a separate requirement that lawyers may only keep pooled trust accounts at financial institutions that meet the requirements of Rule 1.15.

The rule calls for the State Bar of Michigan to establish guidelines for the process for approval and termination of approved status for financial institutions and for other operational procedures to effect this rule. These guidelines may specify the notification process and under what circumstances approved status will be withdrawn. For instance, the guidelines might state that approved status may be revoked where the institution demonstrates a "pattern of neglect or showing of bad faith" rather than an inadvertent failure to report an overdraft, or they may describe the manner in which lawyers are notified when their financial institution's approved status is terminated. See *Overdraft Implementation Guidelines*, 115 N.J.L.J. (215/85) at 1.

This rule becomes effective ____ months from the date of issuance.

SAMPLE TRUST ACCOUNT OVERDRAFT NOTIFICATION AGREEMENT

The undersigned, being a duly authorized officer of the named financial institution and the person or persons specifically authorized to enter into this agreement, hereby applies to be approved to hold attorney trust accounts, including IOLTA and non-IOLTA accounts, pursuant to the requirements of Michigan Rule of Professional Conduct 1.15. In consideration for the approval of the named financial institution, the institution agrees to comply with the overdraft reporting requirements set forth in Michigan Rules of Professional Conduct 1.15A as amended from time to time.

The named financial institution agrees:

- 1) To report to the Attorney Grievance Commission and to the account holder when any properly payable instrument is presented against a lawyer's trust account containing insufficient funds, whether or not the instrument is honored and irrespective of any overdraft protection or other similar privileges that may attach to such account.. The financial institution acknowledges that trust account funds may not be used for overdraft protection or similar privileges for any other account.
- 2) That all such reports shall contain the following information:
 - (a) the identity of financial institution
 - (b) the identity of the lawyer or the law firm
 - (c) the account number
 - (d) a copy of the instrument
 - (e) the amount of overdraft and date created and either:
 - 1) the amount of the returned instrument(s) and the date returned, or
 - 2) date of presentation for payment and the date paid
- 3) In the case of a dishonored instrument, the financial institutions may submit a copy of the dishonored instrument and a copy of the notice of dishonor it sends to the account holder if the notice of dishonor contains the information at 2)(a)-(e)1) above.
- 4) That the information required by this agreement shall be provided within five banking days of the date the item(s) was paid or returned unpaid.
- 5) The financial institution agrees to respond to reasonable requests from the State Bar of Michigan and the Attorney Grievance Commission regarding the financial institution's internal processes pertaining to instruments presented against accounts

containing insufficient funds so that the State Bar of Michigan can promulgate the guidelines referenced in MRPC 1.15.A

6) The agreement applies to all branches of the financial institution and to any successor entity to the financial institution and cannot be cancelled except on ninety (90) days notice in writing to the State Bar of Michigan. Upon cancellation or termination of the agreement, the financial institution agrees to notify all holders of trust accounts subject to the provisions of this rule at least sixty (60) days prior to termination of approved status that the financial institution will no longer be approved to hold such trust accounts.

7) The State Bar of Michigan may terminate this agreement on 90 days written notice to the financial institution if the State Bar determines in its sole discretion that the financial institution has failed to comply with the terms of this agreement. Within this 90 day period, the State Bar may offer the financial institution an opportunity to correct such non-compliance within 30 days.

8) Within 30 days after the change of financial institution information included in this agreement (e.g., through change of contact person, change of bank name, bank merger, etc.) the financial institution will notify the State Bar of Michigan in writing of such change.

Date:

Signature of authorized officer

Name and designation of authorized officer
(please type or print)

Financial Institutin Contact Information:

Current Address of Attorney Grievance Commission to which all Overdraft Reports should be sent:

243 W. Congress Street, Suite 256

Detroit, MI 48826

Phone:

Fax:

E-mail:

Notary clause

AMERICAN BAR ASSOCIATION
 STANDING COMMITTEE ON CLIENT PROTECTION

State by State Adoption of ABA Client Protection Programs

	Trust ¹ Account Overdraft Notification (36)	Random ² Audit of Trust Accounts (11)	Payee ³ Notification (10)	Disclosure ⁴ of Insurance (17)	Mandatory ⁵ Fee Arbitration (12)	Mediation ⁶ Non-Fee Disputes (23)
AL	Yes	No	No	No	No	No
AK	No	No	No	Yes	Yes	Yes
AZ	Yes	No	No	Yes	No	Yes
AR	Yes	No	No	No	No	No
CA	Yes	No	Yes	No	Yes	Yes
CO	Yes	No	No	No	No	No
CT	Yes	No	Yes	No	No	Yes
DE	Yes	Yes	Yes	Yes	No	Yes
DC	Yes	No	No	No	Yes	No
FL	Yes	No	No	No	No	Yes
GA	Yes	No	Yes	No	Yes	Yes
HI	Yes	Yes	No	No	No	No
ID	Yes	No	No	No	No	No
IL	No	No	No	Yes	No	No
IN	Yes	No	No	No	No	Yes
IA	Yes	Yes	No	No	No	No
KS	Yes	Yes	Yes	Yes	No	No
KY	Yes	No	No	No	No	Yes

	Trust Account Overdraft Notification	Random Audit of Trust Accounts	Payee Notification	Disclosure of Insurance	Fee Arbitration	Mediation Non-Fee Disputes
LA	Yes	No	No	No	No	Yes
ME	No	No	No	No	Yes	No
MD	Yes	No	No	No	No	Yes
MA	Yes	No	No	No	No	No
MI	No	No	No	Yes	No	No
MN	Yes	No	No	No	No	No
MS	No	No	No	No	No	Yes
MO	No	No	No	No	No	Yes
MT	Yes	No	No	No	Yes	No
NE	No	Yes	No	Yes	No	No
NV	Yes	No	Yes	Yes	No ⁷	No
NH	No	Yes	No	Yes	No	No
NJ	Yes	Yes	Yes	No	Yes	No
NM	No	No	No	Yes	No	Yes
NY	Yes	No	Yes	No	Yes	Yes
NC	Yes	Yes	No	Yes	Yes	Yes
ND	No	No	No	No	No	No
OH	Yes	No	No	Yes	Yes	No
OK	No	No	No	No	No	No
OR	Yes	No	No	Mandatory Ins. Req.	No	Yes
	Trust Account	Random Audit of	Payee Notification	Disclosure of	Fee Arbitration	Mediation Non-Fee

	Overdraft Notification	Trust Accounts		Insurance		Disputes
PA	Yes	No	Yes	Yes	No	Yes
RI	Yes	No	Yes	No	No	No
SC	Yes	No	No	No	Yes	No
SD	No	No	No	Yes	No	No
TN	Yes	No	No	No	No	No
TX	No	No	No	No	No	Yes
UT	Yes	No	No	No	No	Yes
VT	Yes	Yes	No	No	No	Yes
VA	Yes	No	No	Yes	No	No
WA	Yes	Yes	No	No	No	Yes
WV	No	No	No	Yes	No	No
WI	Yes	No	No	No	No	No
WY	No	No	No	No	Yes	Yes

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¹ ABA Model Rules for Trust Account Overdraft Notification:: <http://www.abanet.org/cpr/clientpro/opreface.html>

² ABA Model Rules for Random Audit of Lawyer Trust Accounts: <http://www.abanet.org/cpr/clientpro/apreface.html>

³ ABA Model Rule for Payee Notification: <http://www.abanet.org/cpr/clientpro/ppreface.html>

⁴ ABA Model Court Rule on Insurance Disclosure:
http://www.abanet.org/cpr/clientpro/Model_Rule_InsuranceDisclosure.pdf
 Includes Oregon which mandates insurance.

⁵ ABA Model Rules for Fee Arbitration:: <http://www.abanet.org/cpr/clientpro/fapreface.html>

⁶ ABA *Model Rules for Mediation of Client-Lawyer Disputes*: <http://www.abanet.org/cpr/clientpro/medpreface.html>

⁷ In 2004, the Bar's Board of Governors approved amending the Fee Dispute Arbitration By-Laws to read, "...if during two (2) years prior to the filing of the binding arbitration agreement by the petitioner, the respondent attorney has been the subject of three (3) or more fee disputes within the jurisdiction of the Committee, then the fee dispute arbitration proceeding shall become mandatory."