A LAWYER'S PROFESSIONAL RESPONSIBILITY IN IDENTIFYING AND AVOIDING COUNTERFEIT CHECKS

Adopted: July 16, 2021

Opinion discusses a lawyer's professional responsibility to safeguard entrusted funds by identifying and avoiding purported transactions involving counterfeit checks.

Inquiry #1:

Client contacted Lawyer seeking to collect debt from a third party. Client's communication with Lawyer was unsolicited – Lawyer does not advertise for his practice, and Lawyer had not previously solicited Client's business. Client provided Lawyer with documentation supporting Client's claim. Lawyer made preliminary investigation and verified the existence and address of third party. Lawyer contracted with Client to file a lawsuit against third party for the amount owed to Client. A few days after Lawyer sent third party a letter introducing himself as Client's representative, third party contacted Lawyer stating that he wished to pay the amount owed to Client without the need for litigation, and that third party would be back in touch to make payment arrangements. Without further communication with third party, Lawyer subsequently received a cashier's check from third party drawn on an out-of-country bank. The cashier's check was dated prior to third party's earlier conversation with Lawyer, and third party did not mention the cashier's check to Lawyer. Third party's note also stated that he would pay the remainder of debt owed to Client within weeks. Lawyer did no further investigation of third party and did not investigate the authenticity of the foreign bank cashier's check.

Did Lawyer violate the Rules of Professional Conduct by not investigating the authenticity of the foreign bank cashier's check?

Opinion #1:

Yes. Lawyer violated his duties of competency and diligence in representing Client because the scenario described above raises a number of red flags that should alert a lawyer practicing today to the potential for fraud in both the representation and the receipt and disbursement of funds. Rules 1.1 and 1.3.

A lawyer's duty of competency requires the lawyer to have the necessary "legal knowledge, skill, thoroughness, and preparation reasonably necessary for the representation." Comment 8 to Rule 1.1 further states,

To maintain the requisite knowledge and skill, a lawyer should keep abreast of changes in the law and its practice, including the benefits and risks associated with the technology relevant to the lawyer's practice, engage in continuing study and education, and comply with all continuing legal education requirements to which the lawyer is subject.

The fraud accomplished through the counterfeit check scam described in the present inquiry is, unfortunately, not a new problem for the legal community. State and federal agencies have alerted the public to the existence and persistence of these counterfeit check scams for some time. *See, e.g.*, *Counterfeit Check Scams*, North Carolina Department of Justice, https://ncdoj.gov/protecting-consumers/sweepstakes-and-prizes/counterfeit-check-scams/; *How to Spot, Avoid and Report Fake Check Scams*, Federal Trade Commission, https://www.consumer.ftc.gov/articles/how-spot-avoid-and-report-fake-check-scams. Similarly, state and national bar associations, lawyer regulatory bodies, and malpractice carriers have reported on and alerted lawyers to the reality that such scams often target members of the legal profession. *See, e.g.*, *Six Indicted in $32M Internet Collection Scam That Snagged 80 Lawyers*, ABA Journal (Nov. 22, 2010), https://www.abajournal.com/news/article/six_indicted_in_32m_internet_collection_scam_that_snagged_80_lawyers/; *Counterfeit Check Scams Continue to Target Law Firms*, California Bar Journal (January 2012), https://www.calbarjournal.com/January2012/TopHeadlines/TH6.aspx; New York City Bar Formal Ethics Opinion 2015-3, *Lawyers Who Fall Victim to Internet Scams* (April 22, 2015), https://www.nycbar.org/member-and-career-services/committees/reports-listing/reports/detail/formal-opinion-2015-3-lawyers-who-fall-victim-to-internet-scams; Laura Loyek, *Counterfeit Check Scams are Still Snaring Lawyers*, Lawyers Mutual North Carolina (March 22, 2019), https://www.lawyersmutualnc.com/risk-management-resources/articles/counterfeit-check-scams-are-still-snaring-lawyers; Joanna Herzik, *Scams Continue to Target Texas Attorneys*, Texas Bar Blog (July 14, 2020), https://blog.texasbar.com/2020/07/articles/law-firms-and-legal-departments/scams-continue-to-target-texas-attorneys/; *E-Mail Scams and Lawyer Trust Accounts*, Illinois Attorney Registration and Disciplinary Commission, https://www.iardc.org/information/alert.html. The North Carolina State Bar has also published a number of warnings to the legal profession in North Carolina about these scams. *See, e.g.*, *New Variation of Fake Check Scam Targets Law Practices, North Carolina State Bar* (December 6, 2010), /news-publications/news-notices/2010/12/fake-check-scam/; Bruno Demoli, *Bruno's Top Tips: Protect Yourself from Financial Con-Artists*, North Carolina State Bar Journal (Fall 2011 pp. 34 & 37); *Alert: Beware of Scams that Target NC Law Practices*, North Carolina State Bar (January 8, 2016), /news-publications/news-notices/2016/01/scams-targeting-nc-law-practices/. These publications describe the scenarios associated with the scams and identify the relevant warning signs to assist lawyers in detecting and avoiding such scams.

Lawyer's mistaken reliance on the counterfeit check is unexcused. Given the breadth of notice provided to the legal profession on this common scam, Lawyer should have realized that the circumstances surrounding this purported representation required additional investigation. As noted above, Lawyer has a duty to represent his clients with competency and diligence. Rules 1.1 and 1.3. Lawyer's duty of competency includes the need to "keep abreast of changes in the law and its practice[.]" Rule 1.1. For at least ten years, lawyers have been warned about being targets of scams such as the one at issue in this inquiry. Lawyer should have been alerted to the suspicious nature of this transaction based upon the circumstances in this scenario, including the unsolicited request for the representation; the willingness of the purported defendant to quickly resolve the dispute without much effort from Lawyer; the cashier's check drawn on an out-of-country bank; and the cashier check being dated prior to Lawyer's conversation with the purported defendant Although one of these circumstances standing alone may not give cause for

suspicion, the totality of the circumstances should have alerted Lawyer to the suspicious nature of the representation and the transaction. Lawyer's failure to recognize the scam given the vast notice and information directed to lawyers on the topic demonstrated his lack of competency in violation of Rule 1.1. Furthermore, given the suspicious nature of the representation and transaction, Lawyer should have diligently investigated the legitimacy of the cashier's check. Lawyer could have accomplished this by contacting the bank that issued the cashier's check to confirm authenticity, or Lawyer could have informed Client of his concerns and waited to see that the cashier's check was in fact honored and accepted by the issuing bank.

Inquiry #2:

Lawyer deposited the cashier's check into his firm's trust account. Lawyer notified Client of Lawyer's receipt of payment from third party. Client directed Lawyer to promptly deduct 20% of the cashier's check for Lawyer's fee and to disburse the rest of the money via two disbursements: one to an account in another state and the remainder to an account in a different country. The day after Lawyer deposited the cashier's check into his trust account, Lawyer called his bank and was informed that the funds from the cashier's check were available. Without clarifying what available means, Lawyer then proceeded to make the disbursements from his trust account per Client's direction.

Subsequently, the foreign bank upon which third party's cashier's check was drawn became suspicious and determined that the cashier's check was counterfeit. Lawyer was unable to recall and recover the trust account disbursements made to Client's accounts. Lawyer then replenished the disbursed funds, including his fee, to his trust account using funds from his operating account. Lawyer reported the incident to the State Bar's Trust Account Compliance Counsel, expressing remorse and stating that his reliance on the counterfeit cashier's check was an unintentional mistake.

Did Lawyer violate the Rules of Professional Conduct by depositing the check into his trust account and making the disbursements as directed by Client from the trust account?

Opinion #2:

Yes. By disbursing funds from Lawyer's trust account on Client's behalf when Lawyer did not actually have funds belonging to Client in Lawyer's trust account, Lawyer disbursed entrusted funds belonging to other clients in violation of Rules 1.15-2(a), (k), and (n). Safeguarding entrusted client funds is one of the most important professional responsibilities that a lawyer possesses. The Rules of Professional Conduct require lawyers to deposit and hold entrusted client funds in the lawyer's general or dedicated trust account, and to only disburse those funds for the client's benefit upon the client's directive. Rules 1.15-2(a), (b), and (n). Rule 1.15-2(k) specifically prohibits a lawyer from using "any entrusted property to obtain credit or other personal benefit for . . . any person other than the legal or beneficial owner of that property."

Although Lawyer believed he was disbursing Client's funds from his trust account after depositing the purportedly valid cashier's check, Lawyer actually disbursed funds belonging to his other clients because the cashier's check was counterfeit and resulted in no actual deposit of funds belonging to Client into Lawyer's trust account. Lawyer's disbursement of other clients' funds to Client and to himself occurred without his other clients' permission. By disbursing his other clients' funds from his trust account without their permission and for the benefit of someone other than the client, Lawyer misappropriated entrusted client funds in violation of Rules 1.15-2(a), (k), and (n).

RPC 191 references N.C. Gen. Stat. §45A-4 (Good Funds Settlement Act) and rules that a lawyer may make disbursements from his or her trust account in reliance upon the deposit of funds provisionally credited to the account if the funds are deposited in the form of cash, wired funds, cashier's check, or by specified instruments which, although they are not irrevocably credited to the account upon deposit, are generally regarded as reliable. However, a lawyer should never disburse against any provisionally credited funds unless he or she reasonably believes that the underlying deposited instrument is virtually certain to be honored when presented for collection. RPC 191. When reasonably identifiable suspicious circumstances are present surrounding the receipt and disbursement of funds, a lawyer should not disburse on provisional credit – even if statutorily authorized to do so – until the lawyer satisfies him or herself that the instrument is authentic and the transaction is legitimate. Lawyer's failure to do so in this situation not only unnecessarily put other clients' funds at risk but resulted in actual harm to his clients through the misappropriation of his clients' funds.

Inquiry #3:

Does Lawyer have a duty to replace the funds that were improperly disbursed as a result of the counterfeit check scam?

Opinion #3:

Yes. Under these circumstances, Lawyer failed to follow the Rules of Professional Conduct with regards to competency, diligence, and safekeeping of funds. *See* Opinion #1. Because Lawyer's failure to follow the Rules of Professional Conduct is a proximate cause of the loss of entrusted client funds, Lawyer is professionally obligated to replace the misappropriated funds. *See* 2015 FEO 6.

Inquiry #4:

Does Lawyer have a duty to report to the State Bar's Trust Account Compliance Counsel the misappropriation of funds from Lawyer's trust account resulting from the deposit and disbursement of the fraudulent cashier's check?

Opinion #4:

Yes. Rule 1.15-2(p) states that, "[a] lawyer who discovers or reasonably believes that entrusted property has been misappropriated or misapplied shall promptly inform the Trust Account Compliance Counsel (TACC) in the North Carolina State Bar Office of Counsel." Even if Lawyer promptly replenished the funds disbursed after learning the cashier's check was counterfeit, a misappropriation of funds belonging to other clients occurred that requires reporting to the State Bar under Rule 1.15-2(p).

A LAWYER'S RESPONSIBILITY IN AVOIDING FRAUDULENT ATTEMPTS TO OBTAIN ENTRUSTED CLIENT FUNDS

Adopted: January 15, 2021

Opinion discusses a lawyer's professional responsibility to inform clients about relevant, potential fraudulent attempts to improperly acquire client funds during a real property transaction.

Facts:

Buyer in a real estate transaction retained Lawyer as settlement agent. At the outset of the representation, Lawyer sent Buyer an informational letter including instructions for wiring closing proceeds to Lawyer's trust account. Lawyer's letter includes a warning about potential wire fraud associated with the transaction, and that in order to prevent wire fraud Buyer should telephone Lawyer's office using the number listed in the letterhead before initiating the wire to verify the wiring instructions. The letter also states that Lawyer will not change wire instructions via email.

On the date of the scheduled real estate closing, Buyer telephoned Lawyer's office and left a voicemail inquiring about wiring instructions for sending closing proceeds to Lawyer's trust account. Minutes later, Buyer received an e-mail message purporting to be from Lawyer indicating that Buyer should ignore Lawyer's previous wire instructions and instead should utilize new wire instructions that were attached to the email. This e-mail was not sent by Lawyer or by anyone acting under Lawyer's direction. The e-mail did not have an attachment, so Buyer replied to the email noting the lack of an attachment. In response, Buyer unknowingly received fraudulent wiring instructions and initiated the wire transfer of the closing proceeds to what he thought was the Lawyer's trust account but was actually to a third party's fraudulent account. When Buyer appeared at closing and inquired about Lawyer's receipt of the closing proceeds, Lawyer discovered that the funds had never been received into his trust account.

Inquiry #1:

Did Lawyer violate the Rules of Professional Conduct by failing to prevent the fraudulent wire transfer of Buyer's proceeds?

Opinion #1:

No. Lawyer's letter to Buyer at the outset of the representation containing a warning about the potential for wire fraud and instructions to the client to personally confirm wire transfer instructions via telephone to Lawyer's office reasonably minimize the risks associated with the transfer of funds during a real property transaction.

Lawyers have a duty to competently represent clients and to communicate with clients concerning the representation. Rules 1.1 and 1.4. A lawyer's duty of competency requires the lawyer to have the necessary "legal knowledge, skill, thoroughness, and preparation reasonably necessary for the representation." Comment 8 to Rule 1.1 further states,

To maintain the requisite knowledge and skill, a lawyer should keep abreast of changes in the law and its practice, including the benefits and risks associated with the technology relevant to the lawyer's practice, engage in continuing study and education, and comply with all continuing legal education requirements to which the lawyer is subject.

In addition to accepting and pursuing a client's matter with the requisite competence, a lawyer must adequately communicate with the client about "the means by which the client's objectives are to be accomplished" and to "explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation." Rules 1.4(a)(2) and 1.4(b); *see also* Rule 1.4 [cmt. 5] ("The client should have sufficient information to participate intelligently in decisions concerning the objectives of the representation and the means by which they are to be pursued, to the extent the client is willing and able to do so.").

Safeguarding entrusted client property is one of the most important aspects of a lawyer's practice. In addition to complying with the requisite safeguards set out in Rule 1.15 in handling entrusted property, a lawyer must also make efforts to educate him or herself on the potential risks associated with the transfer of funds, including the risks to client funds that exist prior to a lawyer's possession of the funds, and ensure that those involved in a particular transaction are aware of such risks. *See* Rules 1.1, 1.4, and 5.3; *see also* 2015 FEO 6. Unfortunately, scams and other attempts to divert and fraudulently acquire client funds associated with a real property transaction are ever-present, increasing, and evolving. Furthermore, these scams have been widely reported on by various outlets, including the State Bar and the news media. *See generally* North Carolina State Bar, *Alert: Compromised Email/Wire Instructions Fraud Continues to Target North Carolina Lawyers* (May 23, 2017), /news-publications/news-notices/2017/05/alert-compromised-emailwire-instructions-fraud-continues-to-target-north-carolina-lawyers/; Caroline Biggs, *How To Protect Yourself From Real Estate Scams*, N.Y. Times (Jan. 3, 2020), https://www.nytimes.com/2020/01/03/realestate/how-to-protect-yourself-from-real-estate-scams.html. Given the constant threat to client funds and the significant harm that can result from such fraudulent activity, a lawyer's duty in representing clients in real property transactions necessarily requires the lawyer to be vigilant in reasonably educating him or herself on the current state of such fraudulent attempts and in communicating with clients and staff about such risks.

In 2015 FEO 6, the Ethics Committee addressed a lawyer's professional responsibility to safeguard entrusted funds from third party interference, including theft. There, the committee determined that a lawyer who has taken reasonable care to minimize the risks to client funds by implementing reasonable security measures in compliance with the requirements of Rule 1.15 is not ethically obligated to replace funds that are stolen from the lawyer's trust account. The committee also cited a prior ethics opinion in explaining a lawyer's continuing obligation to educate him or herself about the relevant and evolving risks associated with the lawyer's practice

and handling of entrusted client funds ("In 2011 FEO 7 the Ethics Committee opined that a lawyer has affirmative duties to educate himself regularly as to the security risks of online banking; . . . and to ensure that all staff members who assist with the management of the trust account receive training on and abide by the security measures adopted by the firm.").

In the present inquiry, Lawyer has not yet received entrusted property from Buyer, and thus Rule 1.15 is not yet implicated. However, Lawyer has a duty to competently represent Buyer in the real estate transaction and to "keep abreast of changes in the law and its practice, including the benefits and risks associated with the technology relevant to the lawyer's practice[.]" Rule 1.1 [cmt. 8]. Lawyer also has a duty to adequately and effectively inform Buyer about the potential risks associated with the transfer of funds in connection with a real property transaction so that Buyer can make "informed decisions regarding the representation." Rule 1.4(b). Similar to the situation addressed in 2015 FEO 6, a lawyer satisfies his or her professional obligation if s/he takes reasonable measures to educate him or herself on real property transaction scams; implements within the lawyer's practice (including staff) reasonable measures to minimize the risks to client funds in accordance with the Rules of Professional Conduct; and adequately communicates to the client the risks associated with the transfer of funds in connection with a real property transaction and clear instructions on how to safely transfer funds to complete the real property transaction. Accordingly, Lawyer has fulfilled his professional responsibility with regards to Buyer and the underlying real property transaction.

Inquiry #2:

Same scenario as Inquiry #1, but Lawyer failed to send the letter at the outset of the representation containing the warning about wire fraud and the instructions for verifying wire transfer instructions at closing. Lawyer did not otherwise provide any warning to Buyer about potential wire fraud, Lawyer did not provide instructions specifically described to avoid wire fraud, and Lawyer has not made any effort to educate himself or his staff about the potential for wire fraud in connection with real property transactions conducted by Lawyer's law office.

Does Lawyer's failure to provide any warning to Buyer or otherwise take steps to avoid potential wire fraud violate the Rules of Professional Conduct?

Opinion #2:

Yes. As noted above, scams and other attempts to divert and fraudulently acquire client funds associated with a real property transaction are ever-present, increasing, and evolving. A lawyer serving as a settlement agent for real property transactions has a duty to implement reasonable measures to minimize the risks associated with the transfer of funds in real property transactions, including to be aware of and educated on these developments, and to communicate with his client about these risks and how the lawyer intends to avoid them. *See* Opinion #1.

Inquiry #3:

Same scenario as Inquiry #1, but instead of Lawyer sending a letter to Buyer at the outset of the representation containing the warning and instructions regarding wire fraud, Lawyer includes the warning and instructions as generic language at the end of all of Lawyer's sent emails. Does this effort satisfy Lawyer's obligation to communicate with Buyer about the risks associated with wire fraud in real property transactions?

Opinion #3:

Yes, provided Lawyer specifically alerted Buyer to the language contained in the email and directed Buyer to read the language in its entirety. The medium by which this language is communicated to Buyer is not as material as Lawyer's clear communication of the information to Buyer. If Lawyer directs Buyer's attention to the warning and instructions contained in an email, Lawyer has satisfied his obligation to adequately communicate with Buyer to enable Buyer to make informed decisions about the representation. Rule 1.4(b). Lawyer does not satisfy his professional responsibility by simply including the language at the end of an email without any direction to Buyer to read the language, as such language can often go overlooked and unread by the email recipient.

Similar to 2011 FEO 7's discussion of a lawyer's professional responsibility in using online banking, this opinion does not set forth specific requirements beyond those of education and adequate communication needed to minimize the risks associated with wire fraud. As noted in 2011 FEO 7, imposing specific requirements can "create a false sense of security in an environment where the risks are continually changing. Instead, due diligence and frequent and regular education are required."

Inquiry #4:

Same scenario as Inquiry #1, but prior to Lawyer providing any instruction or information to Buyer, Lawyer learns that Buyer received documentation from a third party (e.g. Buyer's realtor or Buyer's lending institution) warning Buyer about the dangers associated with wire fraud in residential real property transactions. Must Lawyer still warn Buyer about the dangers associated with wire fraud in light of the third party's warning/information previously provided to Buyer?

Opinion #4:

Yes. Lawyer's knowledge that a third party provided similar warnings to Buyer does not absolve Lawyer of his professional responsibility to competently represent Buyer and communicate any relevant concerns about the transaction.

Inquiry #5:

Does Lawyer have a duty to report the theft of Buyer's funds intended for Lawyer's trust account to the State Bar's Trust Account Compliance Counsel?

Opinion #5:

No. Rule 1.15-2(p) states that, "[a] lawyer who discovers or reasonably believes that entrusted property has been misappropriated or misapplied shall promptly inform the Trust Account Compliance Counsel (TACC) in the North Carolina State Bar Office of Counsel." Rule 1.15-1(f) defines "entrusted property" as "trust funds, fiduciary funds and other property belonging to someone other than the lawyer which is in the lawyer's possession or control in connection with the performance of legal services or professional fiduciary services." At the time of the theft, Buyer's funds were neither in Lawyer's possession nor in Lawyer's control, and thus are not entrusted funds subject to the reporting requirement in Rule 1.15-2(p). However, lawyers are encouraged to report such fraudulent attempts on client funds – successful or unsuccessful – to the State Bar to make the State Bar aware of such attempts and empower the State Bar to issue appropriate alerts and/or guidance to help lawyers and clients avoid future fraudulent efforts.

RECEIPT OF VIRTUAL CURRENCY IN LAW PRACTICE

Adopted: October 25, 2019

Opinion rules that a lawyer may receive virtual currency as a flat fee for legal services, provided the fee is not clearly excessive and the terms of Rule 1.8(a) are satisfied. A lawyer may not, however, accept virtual currency as entrusted funds to be billed against or to be held for the benefit of the lawyer, the client, or any third party.

Introduction:

Virtual currency[1] – most notably, Bitcoin – is increasingly used for conducting business and service-related transactions.[2] Although advocates for and users of virtual currency treat these assets as actual currency, the Internal Revenue Service in 2014 classified virtual currency as property, not recognized currency. *See* IRS Notice 2014-21, https://www.irs.gov/pub/irs-drop/n-14-21.pdf. Accordingly, for the purpose of determining a lawyer's professional responsibility in conducting transactions related to her law practice using virtual currency, this opinion adopts the IRS's position and views virtual currencies as property, rather than actual currency.

Inquiry #1:

Client wants to retain Lawyer for representation in a pending matter. Lawyer charges Client a flat fee for the representation. Client wants to pay Lawyer using virtual currency. May Lawyer accept virtual currency from Client as a flat fee in exchange for legal services?

Opinion #1:

Yes, provided the fee is not clearly excessive and the lawyer complies with the requirements in Rule 1.8(a).

A flat fee is a "fee paid at the beginning of a representation for specified legal services on a discrete legal task or isolated transaction to be completed within a reasonable amount of time[.]" 2008 FEO 10. With client consent, a flat fee is considered "earned immediately and paid to the lawyer or deposited in the firm operating account[.]" *Id.* Rule 1.5(a) prohibits a lawyer from making an agreement for, charging, or collecting an illegal or clearly excessive fee. Comment 4 to Rule 1.5 states that "a fee paid in property instead of money may be subject to the requirements of Rule 1.8(a) because such fees often have the essential qualities of a business transaction with the client." Rule 1.8(a) prohibits a lawyer from entering into a business transaction with a client unless the following provisions are met:

(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;

(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and

(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

Rule 1.8(a)(1) – (3).

As of the date of this opinion, the value of virtual currencies fluctuates significantly and unpredictably from day to day. Considering this extreme fluctuation, any transaction involving virtual currencies inherently involves a great deal of risk by the parties on the ultimate value of the services rendered. Without an express agreement between Lawyer and Client on when the valuation of the virtual currency is determined, Lawyer could receive an inappropriate windfall in the form of extreme overpayment for legal services. Accordingly, considering the nature of the property at issue in this exchange, Client's payment of virtual currency to Lawyer for legal services has "the essential qualities of a business transaction with the client." Rule 1.5, cmt. 4. As such, Lawyer must comply with the requirements of Rule 1.8(a) when conducting a transaction wherein legal services are exchanged for virtual currency. Therefore:

1. Lawyer must ensure the terms of the transaction are fair and reasonable to Client, and Lawyer must fully disclose the terms in writing to Client in a manner that can be reasonably understood by Client. To ensure a flat fee, which is earned upon receipt (*see* 2008 FEO 10), is not clearly excessive under Rule 1.5, and for the purposes of any potential required refunds following withdrawal or termination from the representation, Lawyer and Client must reach a mutually agreed upon determination of the value of the virtual currency exchanged at the time of the transaction. That valuation must be included as part of the written terms of the transaction;
2. Lawyer must advise Client in writing of the desirability of seeking independent legal counsel on the transaction, and Lawyer must give Client a reasonable opportunity to obtain that counsel; and
3. Lawyer must obtain Client's written, informed consent to the essential terms of the transaction as well as Lawyer's role in the transaction. Although Rule 1.8(a)(3) contemplates that Lawyer could represent Client in this transaction, Lawyer's potentially significant monetary interest in acquiring the virtual currency suggests that Lawyer may not represent Client in the transaction.

This opinion does not reach the legal issues surrounding an individual's receipt of and transacting in virtual currency. Before transacting in virtual currency, lawyers should apprise themselves of the legal ramifications surrounding the use of virtual currency, including potential tax and criminal implications. As with other forms of payment, lawyers should take the appropriate steps to ensure any virtual currency received is not the product of or otherwise connected to illegal activity.

Inquiry #2:

May Lawyer accept virtual currency from a third party on behalf of Client as a flat fee in exchange for legal services rendered?

Opinion #2:

Yes. Lawyer may receive compensation from a third party for the benefit of Client provided that a) Client provides informed consent to Lawyer regarding the third party's virtual currency payment, b) there is no interference with Lawyer's independence of professional judgment, or with the client-lawyer relationship, and c) information obtained by Lawyer during the client-lawyer relationship remains confidential and protected in accordance with Rule 1.6. *See* Rule 1.8(f). *See also* Answer #1.

Inquiry #3:

Client wants to retain Lawyer for representation in a pending matter. Lawyer plans to charge Client an hourly rate for the representation, and Lawyer wants Client to deposit a set amount of virtual currency with Lawyer to be billed against as work is completed by Lawyer. May Lawyer accept virtual currency from Client as an advance payment, against which Lawyer will bill Lawyer's hourly rate?

Opinion #3:

No. An advance payment is "a deposit by the client of money that will be billed against, usually on an hourly basis, as legal services are provided[.]" 2008 FEO 10. The advance payment is "not earned until legal services are rendered" and therefore must be deposited in the lawyer's trust account, with the unearned portion of the advance payment refunded to the client upon termination of the client-lawyer relationship. *Id.* Virtual currency is property and not actual currency; accordingly, virtual currency cannot be deposited in a lawyer trust account or fiduciary account in accordance with Rule 1.15-2. Instead, virtual currency – and all other non-currency property received as entrusted property – must be "promptly identified, labeled as property of the person or entity for whom it is to be held, and placed in a safe deposit box or other suitable place of safekeeping." Rule 1.15-2(d).

Generally, virtual currency is received, held or maintained in, and distributed from an individual's computer (referred to as "cold storage") or in a digital "wallet" typically maintained by an individual through a digital asset exchange. Deidre A. Liedel, *The Taxation of Bitcoin: How the IRS Views Cryptocurrencies*, 66 Drake L. Rev. 107, 111-12 (2018). Holders of virtual currency access and exchange their virtual currency through the use of the holder's public and private keys associated with their virtual currency activity. *See generally* Lisa Miller, *Getting Paid in Bitcoin*, 41 Los Angeles Lawyer 18, 19-20 (December 2018); Carol Goforth, *The Lawyer's Cryptionary: A Resource for Talking to Clients about Crypto-transactions*, 41 Campbell L. Rev. 47, 112-13 (2019). Due to the decentralized nature of virtual currency, exchanges of virtual currency from one account to another cannot be reversed, and a virtual currency holder cannot recover a lost private key to access his or her virtual currency.

The methods in which virtual currency are held are not yet suitable places of safekeeping for the purpose of protecting entrusted client property under Rule 1.15-2(d). Rule 1.15-2(d)'s reference to "a safe deposit box or other suitable place of safekeeping" demonstrates that the "suitable place of safekeeping" referenced in the Rule is one that ensures confidentiality for the client and provides exclusive control for the lawyer charged with maintaining the property, as well as the ability of the client or lawyer to rely on institutional backing to access the safeguarded property through appropriate verification should the lawyer's ability to access the property disappear (be it through the lawyer's misplacement of a physical key, or the lawyer's unavailability due to death or disability). The environment in which virtual currency presently exists, however, does not afford similar features that allow clients to confidently place entrusted virtual currency in the hands of their lawyers. A February 2019 report found that even knowledgeable users of virtual currency experienced a variety of complications and concerning issues in exchanging virtual currency that threatened the execution of and confidence in the exchange, including sending virtual currency to the wrong individual by inputting the wrong public key, losing their own private key (thereby rendering the user's virtual currency permanently inaccessible), or being subject to phishing attacks or other attempted hacks to illegally access their digital wallets. *See* Foundation for Interwallet Operability, *Blockchain Usability Report* (February 2019), https://fio.foundation/wp-content/themes/fio/dist/files/blockchain-usability-report-2019.pdf ("While the blockchain industry has grown dramatically over the last year, usability is clearly still an ongoing struggle and the use of blockchain in actual commerce and utility is still very limited. Blockchain transactions are, by definition, immutable. With immutable transactions, users must have extremely high confidence that transactions are occurring as intended, with the right counter party, for the right amount and for the right type of token. Today – blockchain is still far from achieving that high standard."). Any virtual currency received from a client by a lawyer – including lawyers who are experienced in handling and exchanging virtual currency – is subject to being permanently lost with no recourse available to secure the client's property as a result of a lawyer's private key becoming inaccessible, a lawyer's mistaken input of a public key destination for a transfer of virtual currency, or a sophisticated hack of the lawyer's virtual wallet.

This opinion does not preclude the possibility that, in time, digital wallets and other methods in which virtual currency may be held and exchanged could improve in terms of security and accessibility. Such improvements may warrant reconsideration of this opinion. This opinion also does not address the difficulty in reconciling the frequent and significant fluctuation in value of virtual currency while held by a lawyer during the representation, nor does the opinion address the need to segregate clients' virtual currency or the difficulty associated with investigating claims of lawyer misappropriation of a client's virtual currency. These concerns may present further barriers to a lawyer's ability under the Rules of Professional Conduct to handle virtual currency in an entrusted capacity. However, as of the date of this opinion, and with the primary interest of the State Bar being the protection of the public, the methods in which virtual currency are held and exchanged are not yet suitable places of safekeeping as required by Rule 1.15-2(d) for the proper safeguarding of virtual currency as entrusted client property. Accordingly, a lawyer may not receive, maintain, or disburse entrusted virtual currency.

Inquiry #4:

Client has retained Lawyer for a pending matter. Client and opposing party settle their dispute. As part of the settlement, Client agrees to provide opposing party with a set amount of virtual currency. Client and opposing party ask Lawyer to hold Client's virtual currency in trust for the benefit of opposing party via Lawyer's digital wallet until all settlement terms are satisfied, at which point Lawyer will transfer Client's virtual currency to opposing party. May Lawyer accept virtual currency as entrusted property to be held for the benefit of a third party?

Opinion #4:

No, a lawyer may not receive, maintain, or disburse entrusted virtual currency. *See* Answer #3.

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[1]This opinion uses the Internal Revenue Service's term "virtual currency" in referring to cryptocurrency and other financially-related digital assets.

[2] In light of the abundance of information available on the topics of virtual currency and blockchain technology, this opinion will not recite a detailed overview of technological backgrounds or technical operations of these topics, but instead will presume a basic level of familiarity and understanding with the topic by the reader. For background information on these topics, consider the following resources:

1. Nebraska Ethics Advisory Opinion No. 17-03 (2017);
2. Deidre A. Liedel, *The Taxation of Bitcoin: How the IRS Views Cryptocurrencies*, 66 Drake L. Rev. 107, 111-12 (2018);
3. Lisa Miller, *Getting Paid in Bitcoin*, 41 Los Angeles Lawyer 18, 19-20 (December 2018); and
4. Carol Goforth, *The Lawyer's Cryptionary: A Resource for Talking to Clients about Crypto-transactions*, 41 Campbell L. Rev. 47, 112-13 (2019).

2017 FORMAL ETHICS OPINION 4

SETTLEMENT FUNDS SUBJECT TO STATUTORY LIEN

Adopted: July 28, 2017

Opinion rules that a lawyer is prohibited from disbursing settlement funds pursuant to the client's directive if the funds are subject to a perfected lien.

Inquiry:

Client was injured in a vehicular collision. Client was not at fault for the collision. Client incurred various medical expenses as a result of the collision. Lawyer represents Client in her personal injury case against the driver who caused the collision. All medical providers perfected liens on Client's anticipated recovery pursuant to the requirements for perfection of a medical lien on a personal injury settlement set forth in N.C. Gen. Stat. § 44-49. With Client's consent, Lawyer settled the matter. Lawyer received and deposited Client's settlement proceeds in his trust account. The settlement proceeds do not cover the entirety of Client's medical expenses, so Lawyer prepared a proposed *pro rata* disbursement plan, consistent with N.C. Gen. Stat. §44-50 (lien "shall in no case, exclusive of attorney's fees, exceed 50% of the amount of damages recovered"), and submits the proposal to Client for approval.

Client disapproves of the proposed disbursement, explaining that she does not want one particular medical provider (Provider A) to receive any funds from the settlement. Lawyer advises Client of Provider A's perfected lien, but Client instructs Lawyer not to pay Provider A.

May Lawyer disburse Client's settlement proceeds in accordance with Client's instructions not to pay Provider A such that the funds designated for Provider A are disbursed to Client instead?

Opinion:

No, if the lien is perfected. Generally, a lawyer must follow a client's directives as to the disbursement of settlement proceeds. Rule 1.15-2(n) provides that a lawyer "shall promptly pay or deliver to the client, or to third persons as directed by the client, any entrusted property belonging to the client and to which the client is currently entitled." However, Provider A has perfected a lien against the settlement proceeds pursuant to N.C Gen. Stat. § 44-49. The perfected lien creates a question as to whether Client is "currently entitled" to the share of the settlement proceeds designated for Provider A.

Comment [15] to Rule 1.15 recognizes that a third party may have a lawful claim (such as a medical provider lien) against specific funds in a lawyer's custody, and a lawyer "may have a duty under applicable law to protect such third-party claims against wrongful interference by the client."

The applicable law provides that a lien exists upon any sums recovered as damages for personal injury in any civil action. N.C. Gen. Stat. § 44-49(a). The lien is in favor of any provider to whom the injured person may be indebted for any medical attention rendered in connection with the injury. *Id.* The lien attaches to all funds paid to a lawyer in compensation for or settlement of the personal injury claim. To perfect the lien, the medical provider must furnish an itemized statement, hospital record or medical report, without charge, for the lawyer to use in the resolution of the personal injury claim and give written notice to the lawyer of the lien claim. N.C. Gen. Stat. § 44-49(b).

Before disbursing settlement proceeds subject to a perfected lien, N.C. Gen. Stat. § 44-50 provides that the lawyer "shall retain out of any recovery or any compensation so received a sufficient amount to pay the just and bona fide claims." Section 44-50 further states that a client's instructions for the disbursement of settlement proceeds are "not binding on the disbursing attorney" to the extent that the instructions conflict with the requirements of the medical lien statutes. However, when the client disputes the amount of the claim, N.C. Gen. Stat. § 44-51 provides that payment of the claim is not compelled until the claim is "fully established and determined, in the manner provided by law." Comment [15] to Rule 1.15 provides that when a third-party claim "is not frivolous under applicable law, the lawyer *must refuse* to surrender the property to the client until the claim is resolved" (emphasis added). Therefore, when a statute requires a lawyer not to disburse settlement funds to a client, the lawyer must comply with the law regardless of any instructions by the client to the contrary.

Lawyer must determine whether Provider A's lien is perfected. If so, Lawyer must segregate and retain the funds in question in Lawyer's trust account and inform Client that, absent a prompt resolution of Provider A's claim that is satisfactory to both parties, Lawyer will eventually be obligated to deposit the funds into the court for disposition. In the interim, if a final judgment is entered on Provider A's claim such that the claim is no longer in dispute, pursuant to N.C. Gen. Stat. § 44-50, Lawyer must pay Provider A over the client's objections.

To the extent that RPC 69 and RPC 125 conflict with this opinion, they are overruled.

2001 FORMAL ETHICS OPINION 11

DISBURSEMENTS TO MEDICAL PROVIDERS IN ABSENCE OF MEDICAL LIEN

Adopted: January 18, 2002

Opinion rules that when a client authorizes a lawyer to assure a medical provider that it will be paid upon the settlement of a personal injury claim, the lawyer may subsequently withhold settlement proceeds from the client and maintain the funds in her trust account, although there is no medical lien against the funds, until a dispute between the client and the medical provider over the disbursement of the funds is resolved.

Inquiry:

Attorney settled Client's personal injury claim. Client is now demanding Attorney disburse all proceeds to her, even though there are outstanding medical bills to be paid. For two medical providers, Client signed written assignments of proceeds in the amount of the providers' bills. For one of these providers, Attorney also signed a "letter of protection," with Client's knowledge and authorization, in which Attorney represented that the provider's bill would be paid from the proceeds of any settlement or liquidated judgment. If Client insists that all of the settlement proceeds be paid to her, what should Attorney do?

Opinion:

Rule 1.15-2(m) generally requires a lawyer to disburse settlement proceeds in accordance with the client's instructions.

> The only exception to this rule arises when the medical provider has managed to perfect a valid physician's lien. In such a situation the lawyer is relieved of any obligation to pay the subject funds to his or her client, and may pay the physician directly if the claim is liquidated, or retain in his or her trust account any amounts in dispute pending resolution of the controversy.

RPC 69. A number of ethics opinions hold that settlement funds belong to the client who has the right to determine how to disburse the funds unless there is a valid lien against the funds. See RPC 69, RPC 75, and RPC 125. Thus, if Client instructs Attorney to pay the proceeds to Client rather than the medical providers, Attorney may ignore this instruction if there is a valid lien against the proceeds or other valid legal assignment of the rights in the proceeds. See Revised 2000 FEO 4. Attorney must determine whether the assignments given by Client to the medical providers are valid and whether they create liens against the proceeds. If Attorney determines that liens are created, he may hold the funds in his trust account or pay the providers, over the client's objections, if the providers' claims are liquidated. If the assignments do not create valid liens against the proceeds and no representation of payment was made to the medical provider, then Attorney must give the settlement proceeds to Client.

The ethics opinions have not previously addressed a lawyer's professional responsibility when, in the absence of a valid medical lien or assignment, a client instructs a lawyer to disregard a "letter of protection" or some other specific representation to a medical provider that it will be compensated, in whole or in part, from settlement proceeds or a liquidated judgment. This opinion clarifies when a lawyer may withhold settlement funds from a client in this situation. To the extent that this opinion is inconsistent with previous opinions of the Ethics Committee, the prior opinions are overruled.

When a lawyer makes a representation to a third party with the knowledge and authorization of a client, the representation should be honored. See Rule 4.1 which prohibits a lawyer, in the course of representing a client, from knowingly making a false statement of material fact or law to a third party. However, between the time that a medical provider is told that it will be paid and the time that settlement or judgment proceeds are received, a dispute may arise between the client and the medical provider over the medical bill, or the client may decide to defer payment of the medical provider and instruct the lawyer not to pay the medical provider. In the absence of a liquidated medical lien against the funds, the lawyer may not unilaterally decide whether the funds rightfully belong to the medical provider or to the client. Therefore, the lawyer may hold the portion of proceeds allegedly owed to the medical provider in her trust account until the impasse between the client and the provider is resolved by agreement of the parties, by court order, or by interpleading the funds to the court. See G.S. §1A-1, Rule 22. To insure that medical providers are not mislead, any "letter of protection" or other assurance of payment given to a medical provider must explain that the lawyer will hold disputed settlement funds in the trust account in the event the client subsequently instructs the lawyer not to pay the medical provider.

2015 FORMAL ETHICS OPINION 6

LAWYER'S PROFESSIONAL RESPONSIBILITY WHEN THIRD PARTY STEALS FUNDS FROM TRUST ACCOUNT

Adopted: October 23, 2015

Opinion rules that when funds are stolen from a lawyer's trust account by a third party who is not employed or supervised by the lawyer, and the lawyer was managing the trust account in compliance with the Rules of Professional Conduct, the lawyer is not professionally responsible for replacing the funds stolen from the account.

NOTE: This opinion is limited to a lawyer's professional responsibilities and is not intended to opine on a lawyer's legal liability.

Inquiry #1:

John Doe, a third party unaffiliated with Lawyer, created counterfeit checks that were identical to Lawyer's trust account checks. John Doe made the counterfeit checks, purportedly drawn on Lawyer's trust account, payable to himself and presented the counterfeit checks for payment at Bank. Bank honored some of the counterfeit checks. As a consequence, client funds held by Lawyer in his trust account were utilized for an unauthorized purpose. Lawyer properly supervised all nonlawyer staff participating in the record keeping for the trust account. Lawyer also maintained the trust account records and reconciled the trust account as required by Rule 1.15-3. Lawyer had no knowledge of the fraud and had no opportunity to prevent the theft.

Does Lawyer have a professional responsibility to replace the stolen funds?

Opinion #1:

No.

A lawyer who receives funds that belong to a client assumes the responsibilities of a fiduciary to safeguard those funds and to preserve the identity of the funds by depositing them into a designated trust account. Rule 1.15-2, RPC 191, and 97 FEO 9. The responsibilities of a fiduciary include the duty to ensure that the funds of a particular client are used only to satisfy the obligations of that client. RPC 191 and 97 FEO 9. Rule 1.15-3 requires a lawyer to keep accurate records of the trust account and to reconcile the trust account. A lawyer has an obligation to ensure that any nonlawyer assistant with access to the trust account is aware of the lawyer's professional obligations regarding entrusted funds and is properly supervised. Rule 5.3.

If Lawyer has managed the trust account in substantial compliance with the requirements of the Rules of Professional Conduct (see Rules 1.15-2, 1.15-3, and 5.3) but, nevertheless, is victimized by a third party theft, Lawyer is not required to replace the stolen funds. If, however, Lawyer failed to follow the Rules of Professional Conduct on trust accounting and supervision of staff, and the failure is a proximate cause of theft from the trust account, Lawyer may be professionally obligated to replace the stolen funds. Compare RPC 191 (if a lawyer disburses against provisionally credited funds, the lawyer is responsible for reimbursing the trust account for any losses caused by disbursing before the funds are irrevocably credited).

Under all circumstances, Lawyer must promptly investigate the matter and take steps to prevent further thefts of entrusted funds. Lawyer must seek out every available option to remedy the situation including researching the law to determine if Bank is liable;[1] communicating with Bank to discuss Bank's liability; asking Bank to determine if there is insurance to cover the loss; considering whether it is appropriate to close the trust account and transfer the funds to a new trust account; and working with law enforcement to recover the funds.

Inquiry #2:

Prior to learning of the fraud and theft from the trust account, Lawyer issued several trust account checks to clients and/or third parties for the benefit of a client. Despite the theft, there are sufficient total funds in the trust account to satisfy the outstanding checks. However, because of the theft, funds belonging to other clients will be used if the outstanding checks are cashed.

What is Lawyer's duty to safeguard the remaining funds in the trust account?

Opinion #2:

Lawyer must take reasonable measures to ensure that funds belonging to one client are not used to satisfy obligations to another client. Such reasonable measures include, but are not limited to, requesting that Bank issue stop payments on outstanding trust account checks; providing Bank with a list of outstanding checks and requesting that Bank contact Lawyer before honoring any outstanding checks; and determining if

Bank is liable and, if so, demanding the outstanding checks be covered by Bank. If Lawyer determines Bank is not liable or liability is unclear, Lawyer must maintain the status quo and prevent further loss by not issuing new trust account checks. If payment will be stopped on the outstanding checks, Lawyer must contact the payees and alert them to the problem.

Inquiry #3:

Assume the same facts in Inquiry #2 except there are insufficient funds in the trust account to satisfy the outstanding checks. Must Lawyer deposit funds into the trust account to ensure that the outstanding checks are not presented against an account with insufficient funds?

Opinion #3:

No. In addition to the remedial measures listed in Opinion #2, Lawyer should notify the payees if Lawyer knows that the checks will not clear.

Inquiry #4:

Hacker gains illegal access to Lawyer's computer network and electronically transfers the balance of the funds in Lawyer's trust account to a separate account that is controlled by Hacker. Lawyer's trust account now has a zero balance. Lawyer has written several trust account checks to clients and/or third parties for the benefit of clients. Because of the theft, there are insufficient funds in the trust account to satisfy the outstanding checks.

Does Lawyer have a professional responsibility to replace the stolen funds?

Opinion #4:

No, Lawyer is not obligated to replace the stolen funds provided he has taken reasonable care to minimize the risks to client funds by implementing reasonable security measures in compliance with the requirements of Rule 1.15.

Rule 1.15 requires a lawyer to preserve client property, to deposit client funds entrusted to the lawyer in a separate trust account, and to manage that trust account according to strict recordkeeping and procedural requirements. To fulfill the fiduciary obligations in Rule 1.15, a lawyer managing a trust account must use reasonable care to minimize the risks to client funds on deposit in the trust account. 2011 FEO 7.

In 2011 FEO 7 the Ethics Committee opined that a lawyer has affirmative duties to educate himself regularly as to the security risks of online banking; to actively maintain end-user security at the law firm through safety practices such as strong password policies and procedures, the use of encryption and security software, and the hiring of an information technology consultant to advise the lawyer or firm employees; and to insure that all staff members who assist with the management of the trust account receive training on and abide by the security measures adopted by the firm.

If Lawyer has taken reasonable care to minimize the risks to client funds, Lawyer is not ethically obligated to replace the stolen funds. If, however, Lawyer failed to use reasonable care in following the Rules of Professional Conduct on trust accounting and supervision of staff, and the failure is a proximate cause of theft from the trust account, Lawyer may be professionally obligated to replace the stolen funds.

Inquiry #5:

Lawyer is retained to close a real estate transaction. Prior to the closing, Lawyer obtains information relevant to the closing, including the seller's name and mailing address. Lawyer also receives into his trust account the funds necessary for the closing. Lawyer's normal practice after the closing is to record the deed and disburse the funds. Lawyer then mails a trust account check to the seller in the amount of the seller proceeds.

Hacker gains access to information relating to the real estate transaction by hacking the email of one of the parties (lawyer, realtor, or seller). Hacker then creates a "spoof" email address that is similar to realtor's or seller's email address (only one letter is different). Hacker emails Lawyer with disbursement instructions directing Lawyer to wire funds to the account identified in the email instead of mailing a check to seller at the address included in Lawyer's file as previously instructed.[2] Lawyer follows the instructions in the email without first implementing security measures such as contacting the seller by phone at the phone number included in Lawyer's file to confirm the wiring instructions. After the closing and disbursement, the true seller calls Lawyer and demands his funds. Lawyer goes to Bank to request reversal of the wire. Bank refuses to reverse the wire and will not cooperate or communicate with Lawyer without a subpoena.

While pursuing other legal remedies, does Lawyer have a professional responsibility to replace the stolen funds?

Opinion #5:

Yes. Lawyers must use reasonable care to prevent third parties from gaining access to client funds held in the trust account. As stated in Opinion #4, Lawyer has a duty to implement reasonable security measures. Lawyer did not verify the disbursement change by calling seller at the phone number listed in Lawyer's file or confirming seller's email address. These were reasonable security measures that, if implemented, could have prevented the theft. Lawyer is, therefore, professionally responsible and must replace the funds stolen by Hacker. If it is later determined that Bank is legally responsible, or insurance covers the stolen funds, Lawyer may be reimbursed.

Inquiry #6:

While pursuing the remedies described in Opinion #2, may Lawyer deposit his own funds into the trust account?

Opinion #6:

Yes.

Generally, no funds belonging to a lawyer shall be deposited in a trust account or fiduciary account of the lawyer. Rule 1.15-2(f). The exceptions to the rule permit the lawyer to deposit funds sufficient to open or maintain an account, pay any bank service charges, or pay any tax levied on the account. Id. The exceptions were expanded in 1997 FEO 9 to include the deposit of lawyer funds when a bank would not route credit card chargeback debits to the lawyer's operating account. These exceptions to the prohibition on commingling enable lawyers to fulfill the fiduciary duty to safeguard entrusted funds.

Therefore, notwithstanding the prohibition on commingling, Lawyer may deposit his own funds into the trust account to replace the stolen funds until it is determined whether the Bank is liable for the loss, insurance is available to cover the loss, or the funds are otherwise recovered. If Lawyer decides to deposit his own funds, he must ensure that the trust accounting records accurately reflect the source of the funds, the reason for the deposit, the date of the deposit, and the client name(s) and matter(s) for which the funds were deposited.

Inquiry #7:

With regard to all of the situations described in this opinion, what duties does Lawyer owe to the clients whose funds were stolen?

Opinion #7:

Lawyer must notify the clients of the theft and advise the clients of the consequences for representation; help the clients to identify any source of funds, such as bank liability and insurance, to cover their losses; defer a client's matter (by seeking a continuance, for example) if necessary to protect the client's interest; and explain to third parties or opposing parties as necessary to protect the client's interests. If stop payments are issued against outstanding checks, Lawyer must take the remedial measures outlined in Opinions #1 and #2 to protect the client's interest. Finally, Lawyer must report the theft to the North Carolina State Bar's Trust Accounting Compliance Counsel.

Endnotes

1. See e.g. N.C. Gen. Stat. §25-4-406.

2. The inquiry assumes that Lawyer believed that, by wiring the funds to the account designated in the email, he was disbursing the funds to the seller as required by the settlement statement. This opinion does not address the issues of professional responsibility raised when a lawyer knowingly makes disbursements contrary to a settlement statement.

2013 FORMAL ETHICS OPINION 13

DISBURSEMENT AGAINST FUNDS CREDITED TO TRUST ACCOUNT BY ACH AND EFT

Adopted: January 24, 2014

Opinion rules that a lawyer may disburse immediately against funds that are credited to the lawyer's trust account by automated clearinghouse (ACH) transfer and electronic funds transfer (EFT) despite the risk that an originator may initiate a reversal.

Inquiry:

The originator of an automated clearinghouse (ACH) transfer[1] or an electronic funds transfer (EFT) can initiate a reversal of the transaction. However, the reversal must be requested by the originating bank and approved by the receiving bank. When a bank receives a reversal request, it typically will attempt to obtain authorization from the individual whose account was credited before making a reversal.

May a lawyer disburse immediately against funds that are credited to her trust account by ACH or EFT if there is some risk that the originator may initiate a reversal?

Opinion:

Yes. Electronic funds transfers, whether ACH or EFT, are designed to make funds available immediately, like wired funds. While there is some risk that the originator may initiate a reversal, the risk of reversal is slight. Moreover, the lawyer should get notice from the receiving bank in time to take action to prevent the reversal or otherwise to protect other client funds on deposit in the trust account. See, e.g., 97 FEO 9 (lawyer may accept payments to a trust account by credit card although the bank is authorized to debit the trust account in the event a credit card charge is disputed).

A lawyer is not guilty of professional misconduct if that lawyer, upon learning that an ACH or EFT has been reversed, immediately acts to protect the funds of the lawyer's other clients on deposit in the trust account. This may be done by personally depositing the funds necessary to address the deficit created by the reversal or by securing or arranging payment from sources available to the lawyer other than trust account funds of other clients. See RPC 191.

Endnote

1. When a paper check is converted to an automated clearinghouse (ACH) debit, the check is taken either at the point-of-sale or through the mail for payment, the account information is captured from the check, and an electronic transaction is created for payment through the ACH system. The original physical check is typically destroyed by the converting entity (although an image of the check may be stored for a certain period of time). A law firm may convert the paper checks that it receives on behalf of a client or a client matter for payment to the trust account through the ACH system. Authorized ACH debits from the trust account that are electronic transfers of funds (in which no checks are involved) are allowed provided the lawyer maintains a record of the transaction as required by Rule 1.15-3(b)(3) and (c)(3). The record, whether consisting of the instructions or authorization to debit the account, a record or receipt from the register of deeds or a financial institution, or the lawyer's independent record of the transaction, must show the amount, date, and recipient of the transfer or disbursement, and, in the case of a general trust account, also show the name of the client or other person to whom the funds belong. Nevertheless, checks drawn on a trust account should not be converted to ACH because the lawyer will not receive a physical check or a check image that can be retained in satisfaction of the record-keeping requirements in Rule 1.15-3. The transaction will appear on the lawyer's trust account statement as an ACH debit with limited information about the payment (e.g., dollar amount, date processed, originator of the ACH debit). For this reason, lawyers are required to use business-size checks that contain an Auxiliary-On-Us field in the MICR line of the check because these checks cannot be converted to ACH. See Rule 1.15-3(a). See generally Rule 1.15, comments [17] and [18] .

2011 FORMAL ETHICS OPINION 7

USING ONLINE BANKING TO MANAGE A TRUST ACCOUNT

Adopted: January 27, 2012

Opinion rules that a law firm may use online banking to manage its trust accounts provided the firm's managing lawyers are regularly educated on the security risks and actively maintain end-user security.

Inquiry:

Most banks and savings and loans provide "online banking" which allows customers to access accounts and conduct financial transactions over the internet on a secure website operated by the bank or savings and loan. Transactions that may be conducted via on-line banking include account-to-account transfers, payments to third parties, wire transfers, and applications for loans and new accounts. Online banking permits users to view recent transactions and view and/or download cleared check images and bank statements. Additional services may include account management software.

Financial transactions conducted over the internet are subject to the risk of theft by hackers and other computer criminals. Given the duty to safeguard client property, particularly the funds that a client deposits in a lawyer's trust account, may a law firm use online banking to manage a trust account?

Opinion:

Yes, provided the lawyers use reasonable care to minimize the risk of loss or theft of client property specifically including the regular education of the firm's managing lawyers on the *ever-changing* security risks of online banking and the active maintenance of end-user security.

As noted in [Proposed] 2011 FEO 6, *Subscribing to Software as a Service While Fulfilling the Duties of Confidentiality and Preservation of Client Property*, the use of the internet to transmit and store client data (or, in this instance, data about client property) presents significant challenges. In this complex and technical environment, a lawyer must be able to fulfill the fiduciary obligations to protect confidential client information and property from risk of disclosure and loss. The lawyer must protect against security weaknesses unique to the internet, particularly "end-user" vulnerabilities found in the lawyer's own law office. The lawyer must also engage in frequent and regular education about the security risks presented by the internet.

Rule 1.15 requires a lawyer to preserve client property, to deposit client funds entrusted to the lawyer in a separate trust account, and to manage that trust account according to strict recordkeeping and procedural requirements. *See also* RPC 209 (noting the "general fiduciary duty to safeguard the property of a client") and 98 FEO 15 (requiring a lawyer to exercise "due care" when selecting depository bank for trust account). The rule is silent, however, about online banking.

Nevertheless, online banking may be used to manage a client trust account if the recordkeeping and fiduciary obligations in Rule 1.15 can be fulfilled. The recordkeeping requirements for trust accounts are set forth in Rule 1.15-3. Rule 1.15-3(b)(3) specifically requires a lawyer to maintain the following records relative to the transfer of funds from the trust account:

> all instructions or authorizations to transfer, disburse, or withdraw funds from the trust account (including electronic transfers or debits), or a written or electronic record of any such transfer, disbursement, or withdrawal showing the amount, date, and recipient of the transfer or disbursement, and, in the case of a general trust account, also showing the name of the client or other person to whom the funds belong;

If the online banking software does not provide a method for making an official bank record of the required information when money is transferred from the trust account to another account, such transfers must be handled by a method that provides the required records.

To fulfill the fiduciary obligations in Rule 1.15, a lawyer managing a trust account must use reasonable care to minimize the risks to client funds on deposit in the trust account by remaining educated as to the dynamic risks involved in online banking and insuring that the law firm invests in proper protection and multiple layers of security to address those risks. *See* [Proposed] 2011 FEO 6.

A lawyer who is managing a trust account has affirmative duties to regularly educate himself as to the security risks of online banking; to actively maintain end-user security at the law firm through safety practices such as strong password policies and procedures, the use of encryption, and security software, and the hiring of an information technology consultant to advise the lawyer or firm employees; and to insure that all staff members who assist with the management of the trust account receive training on and abide by the security measures adopted by the firm. Understanding the contract with the depository bank and the use of the resources and expertise available from the bank are good first steps toward fulfilling the lawyer's fiduciary obligations.

This opinion does not set forth specific security requirements because mandatory security measures would create a false sense of security in an environment where the risks are continually changing. Instead, due diligence and frequent and regular education are required. A lawyer must fulfill his fiduciary obligation to safeguard client funds by applying the same diligence and competency to manage the risks of on-line banking that a lawyer is required to apply when representing clients.

2009 FORMAL ETHICS OPINION 4

CREDIT CARD ACCOUNT THAT AVOIDS COMMINGLING

Adopted: April 24, 2009

Opinion rules that a law firm may establish a credit card account that avoids commingling by depositing unearned fees into the law firm's trust account and earned fees into the law firm's operating account provided the problem of chargebacks is addressed.

Inquiry:

To avoid the commingling of client funds with a lawyer's own funds, Rule 1.15-2 of the Rules of Professional Conduct requires payments of mixed funds, unearned fees, and money advanced for costs to be deposited into a lawyer's trust account, and payments for earned fees and reimbursements for expenses advanced by a lawyer to be deposited into a lawyer's operating account. Although a lawyer may accept payment of legal fees by credit card, if there is no way to distinguish a credit card payment for earned fees or costs advanced from a payment for unearned fees or anticipated expenses, all credit card payments must be initially deposited into the lawyer's trust account. Earned fees and expense reimbursements are then withdrawn promptly from the trust account for deposit into the operating account or payment to the lawyer. CPR 129 and RPC 247.

A bank[1] has developed a credit card account specifically for law firms that separates and deposits payments of unearned and earned client funds into trust and operating accounts as appropriate. Payments for unearned fees (and for anticipated expenses) are deposited directly into the participating law firm's trust account and payments for earned fees (and costs advanced) are deposited directly into the firm's operating account. May a lawyer establish such an account?

Opinion:

Yes, the account satisfies a lawyer's professional responsibility to avoid the commingling of funds. Utilization of such an account does not violate Rule 1.15-2(g) which requires mixed funds (funds belonging to the lawyer received in combination with funds belonging to a client) to be deposited into the lawyer's trust account intact and, after deposit, the funds belonging to the lawyer to be withdrawn. The law firm credit card account described in the inquiry separates the funds prior to their deposit and, therefore, the funds are not mixed when received by the lawyer.

A lawyer may set up such an account only if the lawyer is also able to comply with 97 FEO 9 which addresses credit card agreements that give the processing bank the authority to debit or "charge back" an account in the event a credit charge is disputed. The opinion sets forth the following alternative ways to safeguard client funds in a trust account when the credit card agreement gives the bank the authority to debit the lawyer's trust account for a chargeback by a client without prior notice to the lawyer:

attempt to negotiate an agreement with the bank that requires the bank to debit an account other than the trust account in the event of a chargeback; maintain a separate demand deposit account in an amount sufficient to cover any chargeback; request that the bank arrange an inter-account transfer such that the lawyer's operating account will be immediately debited in the event of a chargeback against the trust account; or establish a trust account for the sole purpose of receiving advance payments by credit card which will be transferred immediately to the lawyer's primary trust account.

As noted in 97 FEO 9, "[u]nder all circumstances, a lawyer is ethically compelled to arrange for a payment (from his or her own funds or from some other source) to the trust account sufficient to cover the chargeback in the event that a chargeback jeopardizes the funds of other clients on deposit in the account." Therefore, provided the lawyer can comply with the requirements set forth in 97 FEO 9, the lawyer may establish a credit card account that deposits funds into separate accounts.

Endnote

1. 1. One such account is the Law Firm Merchant Account99 which is offered by Affiniscape Merchant Solutions in association with Bank of America, NA.

2013 FORMAL ETHICS OPINION 3

SAFEKEEPING FUNDS COLLECTED FROM CLIENT TO PAY EXPENSES

Adopted: April 19, 2013

Opinion examines a lawyer's responsibilities when charging and collecting from a client for the expenses of representation.

Inquiry #1:

Attorney hires a court reporter to take a deposition in Client's case. The court reporter transcribes the deposition and delivers the transcript and an invoice to Attorney. Attorney bills Client for the court reporter's services in the amount shown on the invoice. Client gives Attorney the funds to pay the court reporter's invoice. Attorney has not previously paid the court reporter.

May Attorney deposit the funds from Client into Attorney's operating account and write a check on the operating account to pay the court reporter?

Opinion #1:

No. The funds collected from Client were collected for the purpose of paying a third party in connection with the performance of legal services and are, therefore, "entrusted funds." Entrusted funds are funds belonging to someone other than the lawyer which are in the lawyer's possession or control in connection with the performance of legal services or professional fiduciary services. Rule 1.15-1(d). Entrusted funds must be maintained separately from the property of Attorney and deposited in Attorney's trust account in accordance with Rule 1.15-2(b).

Attorney may direct Client to write a check for the court reporter's fee payable directly to the court reporter. Attorney would then forward the check to the court reporter without depositing the check in Attorney's trust account. Rule 1.15 does not prohibit a lawyer who receives a check belonging wholly to a third party from delivering the check to the appropriate recipient without first depositing the check in the lawyer's trust account. Rule 1.15, cmt. [5].

Inquiry #2:

Would the answer to Inquiry #1 change if Attorney considers payment of a court reporter to be the lawyer's obligation?

Opinion #2:

No. It does not matter who has the obligation to pay the court reporter. If a lawyer receives funds from a client for the purpose of paying a third party, the funds are entrusted funds and must be maintained separately from the property of the lawyer in a trust account.

Inquiry #3:

Would the answer to Inquiry #1 change if Attorney is contractually obligated to pay the court reporter's fee regardless of whether Client pays Attorney for this expense?

Opinion #3:

No. Attorney's contractual obligations do not change the fact that Attorney is receiving entrusted funds from a client for the specific purpose of paying a third party.

Inquiry #4:

Would the answer to Inquiry #1 change if Attorney has already paid the court reporter from either his operating account or personal funds prior to receipt of Client's funds?

Opinion #4:

Yes. Attorney has advanced the funds to pay the expenses of representation and Attorney is entitled to reimbursement from the client. Rule 1.8, cmt. [10]. The money paid by Client is not entrusted to Attorney but is owed to him. To avoid commingling client funds with the lawyer's funds as required by Rule 1.15-2(f), Attorney must deposit Client's payment into his operating or personal account.

Inquiry #5:

In the field of patent law, the services of patent lawyers or agents in foreign countries ("foreign agents") are sometimes required in the course of applying for international patents for US clients. On behalf of Client, Patent Attorney arranges for foreign agent services. The foreign agent performs the required services and sends an invoice to Patent Attorney. Patent Attorney bills Client for the foreign agent's services in the amount

shown on the invoice. Client sends Patent Attorney the funds to pay the foreign agent's invoice. Patent Attorney has not previously paid the foreign agent.

Do the answers to Inquiries #1-4 change if the funds at issue are funds received from the client to pay for the services of a foreign agent?

Opinion #5:

No.

Inquiry #6

Patent Attorney and a foreign agent routinely provide services to clients of the other lawyer upon request. The foreign agent and Patent Attorney invoice each other per client matter. The foreign agent and Patent Attorney also have a practice of arranging offsets, such that the total amount due to the foreign agent is reduced by the amount due to Patent Attorney.

When Patent Attorney receives an invoice from the foreign agent for services performed by the foreign agent for one of Patent Attorney's clients, Patent Attorney invoices the client for the amount due for the foreign agent's fee and collects the funds from the client.

Do these additional facts change the answer to Inquiry #5?

Opinion #6:

No.

Inquiry #7:

Under the facts in Inquiry #6, Patent Attorney collects the funds from the client for the foreign agent's fee but does not use that money to pay the foreign agent's fee. Instead Attorney settles the obligation to the foreign agent through offsets or, if no offset agreement can be reached, by payment from Patent Attorney.
Is this permissible?

Opinion #7:

No. If a lawyer collects money from a client for a specific purpose, the lawyer must either (1) use the money received from the client to make the payment for which the money was collected, (2) return the funds to the client, or (3) obtain the client's consent to hold the funds in trust until earned by provision of legal services or used to pay other expenses. Rule 1.15-2.

Inquiry #8:

Under the facts in Inquiry #6, is it permissible for Patent Attorney to offset a client expense with a fee due to Patent Attorney in an unrelated matter?

Opinion #8:

Yes, provided Attorney provides Client with a full accounting and explanation of the cost of the foreign agent's services, the offsets applied to the foreign agent's invoice, and the amount still owed to the foreign agent or owed to Attorney by Client. If a lawyer invoices a client for a specific amount to pay a designated expense, the lawyer must use the money received from the client to pay that expense, return the funds to the client, or obtain the client's consent to deposit the funds in the trust account. See Opinion #7. If an expense was already paid by the lawyer through offsets or the advancing of the lawyer's funds, the lawyer may use the money received from the client to reimburse the lawyer. See Opinion #4. However, offset agreements may never be used by a lawyer to earn a profit on the expenses of representation. See Rule 1.5(a)(prohibiting the charging or collecting of an excess amount for expenses).

Inquiry #9

Would the answers to Inquiries #6-8 change if Patent Attorney considers the obligation to pay a foreign agent to be the lawyer's obligation?

Opinion #9:

No.

Inquiry #10:

Would the answers to Inquiries #6-8 change if Patent Attorney is contractually obligated to pay for the services of the foreign agent regardless of whether Client pays Patent Attorney for those services?

Opinion #10:

No.

Inquiry #11:

Client pays Patent Attorney for the foreign agent's fee after the foreign agent has performed services and invoiced Patent Attorney. Client terminates Patent Attorney's representation and retains Patent Attorney #2. At the time of termination, Patent Attorney has not paid the foreign agent or used offsets to satisfy the obligation to the foreign agent. The foreign agent invoices Patent Attorney #2 for the services provided in Client's matter. Do these additional facts or the potential for this to occur change the answers to Inquiries #5-10?

Opinion #11:

No. Patent Attorney must maintain Client's entrusted funds in Patent Attorney's trust account until returned to Client or until receipt of instructions for disposition from Client or Client's new lawyer. If Client or Patent Attorney #2 instructs Patent Attorney to pay the foreign agent, Patent Attorney must do so promptly. See Rule 1.5-2(m). Similarly, if instructed to do so, Patent Attorney must transfer Client's funds to Patent Attorney #2 for deposit in Patent Attorney #2's trust account where they will be available to pay the foreign agent.

2011 FORMAL ETHICS OPINION 13

RETAINING FUNDS IN TRUST ACCOUNT TO PAY DISPUTED LEGAL FEE

Adopted: October 21, 2011

Editor's note: This opinion is not intended to imply that a lawyer for an estate is required to petition the clerk for approval of the lawyer's fee, however, the personal representative's commission may be reduced if the Clerk of Court does not approve the lawyer's fee in advance.

Opinion rules that client funds or the funds of a third party that are placed in the lawyer's control for the purpose of being safeguarded, managed, or disbursed in connection with a transaction, but which were not designated or identified as funds for the payment of legal fees, may not be retained in the trust account, pursuant to Rule 1.15-2(g), as disputed funds to which the lawyer may be entitled.

Inquiry:

Attorney agreed to represent the Estate of E. E was a North Carolina lawyer who conducted his practice through a professional limited liability company (PLLC), in which he was the sole member. Attorney's representation included collecting the assets and paying the claims of the PLLC with the intention that the PLLC would eventually be dissolved and any remaining assets of the PLLC would be distributed to the estate.

The funds of the estate, approximately $3,000, were deposited in the general trust account for Attorney's law firm and a ledger card for the estate was established. The funds of the PLLC, in excess of $100,000, were also deposited in the trust account and a separate ledger for the PLLC was established. Attorney billed his work for the PLLC separately from his work for the estate in order that the legal fees for the resolution of the PLLC issues would be paid from funds of the PLLC.

Administrator recently terminated the representation and demanded return of the remaining funds of the estate (approximately $2,500) and of the PLLC (approximately $100,000) held in the general trust account of Attorney's law firm.

Attorney contends that his firm is owed $29,000 in legal fees for the representation of the PLLC. Administrator contests these legal fees and did not authorize Attorney to pay the fees from any of the money held in trust.

Rule 1.15-2(g) states:

> [w]hen funds belonging to the lawyer are received in combination with funds belonging to the client or other persons, all of the funds shall be deposited intact. The amounts currently or conditionally belonging to the lawyer shall be identified on the deposit slip or other record. After the deposit has been finally credited to the account, the lawyer may withdraw the amounts to which the lawyer is or becomes entitled. If the lawyer's entitlement is disputed, the disputed amounts shall remain in the trust account or fiduciary account until the dispute is resolved.

May Attorney retain $29,000 in his firm's trust account and transfer only the difference to Administrator until the dispute over the legal fees is resolved?

Opinion:

No, the funds must be returned to Administrator and Attorney may file a claim with the Estate for payment for his legal services.

Rule 1.15-2(g) permits a lawyer to withhold only funds to which the lawyer has a claim to entitlement such as funds deposited as a client's advance payment of a legal fee or funds from a settlement negotiated by the lawyer that, by prior agreement, include a contingent fee. However, client funds or the funds of a third party that are placed in the lawyer's control for the purpose of being safeguarded, managed, or disbursed in connection with a transaction, but which were not otherwise designated or identified as funds for the payment of legal fees, may not be retained in the trust account as disputed funds pursuant to Rule 1.15-2(g). As explained in Comment [14] to Rule 1.15, "[a] lawyer is not required to remit to the client funds that the lawyer reasonably believes represent fees owed. However, a lawyer may not hold funds to coerce a client into accepting the lawyer's contention."

Regardless of whether the funds are identified as funds of the Estate of E or funds of the PLLC, the funds in this inquiry are the property of the Estate of E[1] and were delivered to Attorney for the purpose of being managed by Attorney as a part of his legal services to the estate. The funds are subject to legal requirements to pay the claims of the creditors of the PLLC and of the estate.[2] Moreover, payment of administrative expenses of an estate from estate assets, including attorney's fees, is only permitted on the issuance of an order of the clerk of superior court and requires the clerk to exercise judicial discretion in such matters.[3] A personal representative must file a petition seeking an order from the clerk enabling the payment of attorney's fees by an estate.[4] These legal restrictions on the assets of an estate demonstrate that Attorney had no claim of

entitlement to the funds. Therefore, when the representation ended, Attorney was obliged to deliver all of the funds as directed by Administrator. Rule 1.15-2(m)(a lawyer shall promptly pay or deliver to the client, or to third persons as directed by the client, any entrusted property belonging to the client and to which the client is currently entitled).

Rather than deposit the funds of an estate in a general trust account, estate funds should, in most instances, be deposited in a fiduciary account maintained solely for the deposit of fiduciary funds or other entrusted property of a particular person or entity. Rule 1.15-1(e)(defining "fiduciary account"). In a fiduciary account, the funds can be invested as usually required for prudent management of fiduciary funds. The comment to Rule 1.15 explains that:

> [c]lient funds must be deposited in a general trust account if there is no duty to invest on behalf of the client. Generally speaking, if a reasonably prudent person would conclude that the funds in question, either because they are nominal in amount or are to be held for a short time, could probably not earn sufficient interest to justify the cost of investing, the funds should be deposited in the general trust account. In determining whether there is a duty to invest, a lawyer shall exercise his or her professional judgment in good faith and shall consider the following:
>
> a) The amount of the funds to be deposited;
>
> b) The expected duration of the deposit, including the likelihood of delay in the matter for which the funds are held;
>
> c) The rates of interest or yield at financial institutions where the funds are to be deposited;
>
> d) The cost of establishing and administering dedicated accounts for the client's benefit, including the service charges, the costs of the lawyer's services, and the costs of preparing any tax reports required for income accruing to the client's benefit;
>
> e) The capability of financial institutions, lawyers, or law firms to calculate and pay income to individual clients;
>
> f) Any other circumstances that affect the ability of the client's funds to earn a net return for the client.

Generally, the funds of an estate are of sufficient quantity or will be held for a sufficiently long period of time that deposit in a fiduciary account is required.

Endnotes

1. N.C. Gen. Stat. §57C-6-01(4) provides that E's PLLC dissolved by statute on the 90th day following E's death. E's PLLC and all of its assets are assets of the estate.

2. See N.C. Gen. Stat. §57C-6-05(1) and N.C. Gen. Stat. §28A-19-6.

3. See Wachovia Bank & Trust Co. v. Waddell, 237 N.C. 342, 75 S.E. 2d 151 (1953).

4. See In re Estate of Longest, 74 N.C. App. 386, 328 S.E. 2d 804, cert. denied and appeal dismissed, 314 N.C. 330, 333 S.E. 2d 488 (1985).

2008 FORMAL ETHICS OPINION 10

GUIDELINES FOR FEES PAID IN ADVANCE

Adopted: October 24, 2008

Opinion surveys prior ethics opinions on legal fees, sets forth the ethical requirements for the different types of fees paid in advance, authorizes minimum fees earned upon payment, and provides model fee provisions.

Background:

Although there are several ethics opinions on the ethical requirements relative to the different types of legal fees that are charged and collected at the beginning of the representation of a client, the information in these opinions is not gathered in one place and the opinions appear to provide contradictory or inconsistent advice. In addition, the confusion among lawyers as to the ethical requirements for legal fees paid prior to representation has lead to poorly crafted fee agreements. In response to these concerns, this opinion sets forth the key ethical obligations when charging and collecting legal fees, surveys the opinions on legal fees, reconciles the holdings in the opinions, and provides model provisions for fee agreements that satisfy the requirements of the Rules of Professional Conduct and the ethics opinions.

Key Ethical Obligations

Regardless of the type of fee, all legal fees must meet the following standard set forth in Rule 1.5(a) of the Rules of Professional Conduct:

A lawyer may not make an agreement for, charge, or collect an illegal or clearly excessive fee....The factors to be considered in determining whether a fee is clearly excessive include the following:

(1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;

(2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;

(3) the fee customarily charged in the locality for similar legal services;

(4) the amount involved and the results obtained;

(5) the time limitations imposed by the client or by the circumstances;

(6) the nature and length of the professional relationship with the client;

(7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and

(8) whether the fee is fixed or contingent.

It may be difficult to determine whether a legal fee is clearly excessive until the representation is concluded and all of the relevant factors are taken into consideration. At that point, a lawyer may be required to disgorge some portion of a fee that he or she has already collected to insure that the total fee is not clearly excessive. 2000 FEO 5. If the client's funds were deposited in the lawyer's trust account, the money is available to return to the client. If, because of the nature of the fee (see discussion below) the client funds were paid to the lawyer, the lawyer may be required to make a refund to the client using his or her own funds.

In addition to avoiding clearly excessive fees, a lawyer must deposit any funds that belong to a client in the lawyer's trust account. Rule 1.15-2(a). This means that any payment that remains the property of the client until earned, usually by the performance of legal services, must be deposited into the lawyer's trust account and may not be withdrawn without the client's consent until earned. When the lawyer is discharged, any money that remains on deposit in the trust account must be paid back to the client.

Finally, a lawyer must deal honestly and fairly with his or her clients and should give a client sufficient information to make reasonable decisions about the representation including decisions about the fee arrangement. See Rule 1.4 and Rule 8.4(c).

Survey of the Opinions

RPC 50 holds that a lawyer may charge and collect a ***general retainer*** as consideration for the exclusive use of the lawyer's services in a particular matter. Such retainers are sometimes referred to as "true retainers" because the money is paid for nothing more than the reservation of the lawyer's time; the legal services provided by the lawyer are separately compensated. The opinion distinguishes the ***general retainer*** from an ***advance payment*** as follows:

> In its truest sense, a retainer is money to which an attorney is immediately entitled and should not be placed in the attorney's trust account. A "retainer" which is actually a deposit by the client of an advance payment of a fee to be billed on an hourly basis is not a payment to which the attorney is immediately entitled. It is really a security deposit and should be placed in the trust account. As the attorney earns the fee, the funds should be withdrawn from the account.

RPC 158 holds that an ***advance payment*** to a lawyer for services to be rendered in the future, in the absence of an agreement with the client that the payment is earned immediately, is a deposit securing the payment of a fee which is yet to be earned. As such, it remains the property of the client and must be deposited in the lawyer's trust account. See also 2005 FEO 13 (minimum fee that is collected at the beginning of a representation and will be billed against at a lawyer's regular hourly rate is neither a ***general retainer*** nor a ***flat fee;*** therefore, minimum fee remains the client's money until earned by the provision of legal services and must remain on deposit in the trust account until earned).

RPC 158 also holds that a lawyer may charge and collect aBI for representation on a specific, discrete legal task such as resolution of a traffic infraction. If the client agrees that the money represents a flat fee to which the lawyer is immediately entitled, the lawyer may pay the money to himself or herself or deposit the money in the firm's general operating account rather than the firm trust account. The agreement of the client that the flat fee is earned upon payment is critical. The opinion warns, however,

> [w]hether the fee portion is deposited in the trust account or paid over to the operating account, any portion of the fee which is clearly excessive may be refundable to the client either at the conclusion of the representation or earlier if [the lawyer's] services are terminated before the end of the engagement.

97 FEO 4 amplifies the definitions for the ***general retainer*** and the flat fee. Both types of fees may be charged and collected at the beginning of a representation and are considered "presently owed" to the lawyer. The ***general retainer*** is "a payment 'for the reservation of the exclusive services of the lawyer which is not used to pay for the legal services provided by the lawyer.'" [Citing and quoting Rule 1.15-1, cmt.[4].] "The true ***general retainer*** finds general application in those instances where corporate clients, merchants or businessmen have a specific need to consult the lawyer on a regular or recurring basis." The opinion admonishes that a ***general retainer,*** like all other fees, must not be clearly excessive and "[w]hat is customarily charged in similar situations may determine whether a specific true ***general retainer*** is clearly excessive."

A flat fee may be earned at the beginning of the representation and is payment "for specified legal services to be completed within a reasonable period of time." "[T]his type of fee provides economic value to the client and the lawyer alike because it enables the client to know, in advance, the expense of the representation and it rewards the lawyer for efficiently handling the matter." A flat fee arrangement is "customarily identified with isolated transactions such as representations on traffic citations, domestic actions, criminal charges, and commercial transactions." The flat fee is collected at the beginning of the representation, treated as money to which the lawyer is immediately entitled, and paid to the lawyer or deposited in the lawyer's general operating account.

The opinion recognizes that a lawyer may charge a client ***hybrid fees.*** Such hybrid fees include a payment that is part ***general retainer*** or flat fee and part advance to secure the payment of fees yet to be earned. With hybrid fees, one portion of the fee is earned immediately and the other portion remains the client's property and must be deposited in the trust account to be withdrawn as earned. "There should be a clear agreement between the lawyer and the client as to which portion of the payment is a true ***general retainer***, or a flat fee, and which portion of the payment is an advance. Absent such an agreement, the entire payment must be deposited into the trust account and will be considered client funds until earned."

With regard to an ***advance payment***, the opinion reiterates that

> [t]he funds advanced by the client and deposited in the trust account may be withdrawn by the lawyer when earned by the performance of legal services on behalf of the client pursuant to the representation agreement with the client. Revised Rule 1.15-1(d). Should the client terminate the relationship, that portion of the advance fee deposited in the lawyer's trust account which is unearned must be refunded to the client.

2000 FEO 5 prohibits the use of the term "nonrefundable fee" in fee agreements while further elucidating the differences between fees earned at the beginning of a representation and payments that are security for a fee which is yet to be earned. The opinion emphasizes that a lawyer may treat an ***advance payment*** as an earned fee (and deposit the money in the firm's operating account) "only if the client agrees that [the] payment may be treated as earned by the lawyer when it is paid." The opinion's most important paragraphs emphasize that there is a duty to refund "any portion of a fee that is clearly excessive regardless of the type of fee that was paid" and, therefore, no fee is truly nonrefundable. "To call such a payment a 'nonrefundable fee' is false and misleading in violation of Rule 7.1." However, a lawyer may agree with a client that "some or all of a fee may be forfeited under certain conditions but only if the amount so forfeited is not clearly excessive in light of the circumstances and all such conditions are reasonable and fair to the client."

Rather than calling a flat fee "nonrefundable," the opinion instructs a lawyer to refer to such a fee as a "prepaid flat fee."

The Types of Fees and Their Characteristics

Based upon the survey of the ethics opinions, these are the types of fees that are paid in advance and their characteristics:

Advance Payment: a deposit by the client of money that will be billed against, usually on an hourly basis, as legal services are provided; not earned until legal services are rendered; deposited in the trust account; unearned portion refunded upon the termination of the client-lawyer relationship.

General Retainer: consideration paid at the beginning of a representation to reserve the exclusive services of a lawyer but not used to pay for actual representation; generally used when corporate or business clients have a specific need to consult a lawyer on a regular basis; earned upon payment; paid to lawyer or deposited in firm operating account; some or all of the retainer is subject to refund if clearly excessive under the circumstances as determined upon the termination of the client-lawyer relationship.

Flat Fee or Prepaid Flat Fee: fee paid at the beginning of a representation for specified legal services on a discrete legal task or isolated transaction to be completed within a reasonable amount of time; fee pays for all legal services regardless of the amount of time the lawyer expends on the matter; if client consents, treated as earned immediately and paid to the lawyer or deposited in the firm operating account; some or all of the flat fee is subject to refund if clearly excessive under the circumstances as determined upon the termination of the client-lawyer relationship.

Hybrid Fee: fee paid at the beginning of a representation that is in part a general retainer or a flat fee and in part an advance payment to secure the payment of fees yet to be earned; one portion of the fee is earned immediately and the other remains the client's property on deposit in the trust account; client must consent and agree to the portion that is a flat fee or a general retainer and earned immediately; unearned portion of the advance payment refunded upon termination of the client-lawyer relationship; flat fee/general retainer portion subject to refund if clearly excessive under the circumstances as determined upon the termination of the client-lawyer relationship.

Reconciling the Opinions

If there is a seeming inconsistency in the ethics opinions it arises from the strict formulation of the general retainer. A lawyer is allowed to charge a general retainer as consideration for the reservation of the lawyer's services and to treat the money as earned immediately. But the client is not given a credit for future legal services up to the value of the retainer. This strikes many lawyers as detrimental to the client's interests and it has lead to the creation of hybrid fees. The strict formulation of the general retainer has been maintained by the Ethics Committee for three important reasons. It avoids the client confusion that is engendered if a client is told that a payment both reserves the lawyer's services and pays for future representation. In addition, requiring general retainers to be separate and distinct from advance fees means that, if an advance fee is charged for future legal services, there is no penalty to the client for deciding to change legal counsel before the advance fee is exhausted and, if a refund is owed to the client because expected services have not been performed, the money is readily available in the trust account.

Upon further reflection, the Ethics Committee has, nevertheless, determined that it is in the client's interest to receive legal services up to the value of a general retainer provided the client fully understands and agrees that the payment the client makes at the beginning of the representation is earned by the lawyer when paid, will not be deposited in a trust account, and is only subject to refund if the charge for reserving the lawyer's services (as opposed to the charge for the legal services performed) is clearly excessive under the circumstances. This newly acknowledged form of fee payment made by a client at the beginning of a representation will be referred to as a minimum fee and have the following characteristics:

Minimum Fee: consideration paid at the beginning of a representation to reserve the exclusive services of a lawyer; lawyer provides legal services up to the value of the minimum fee; earned upon payment; paid to lawyer or deposited in firm operating account; some or all of the minimum fee is subject to refund if clearly excessive under the circumstances as determined upon the termination of the client-lawyer relationship.

To the extent any previous ethics opinion is inconsistent with this opinion, it is overruled.

Model Fee Provisions: Introduction

The Rules of Professional Conduct do not require fee agreements to be in writing unless the fee is contingent on the outcome of the matter. Rule 1.5(c). The fees discussed in this opinion are not contingent and technically a lawyer is not required to put a client's agreement to pay such fees in writing. Nevertheless, given the propensity of clients to misunderstand the purpose of a payment made prior to the commencement of a representation (and whether such a payment will be refunded), a lawyer would be prudent to put in writing any fee agreement that requires a client to make a payment in advance.

In addition to explaining and obtaining the client's consent to charge the specified payments prior to representation, a lawyer's written fee agreement with a client should also contain provisions that fully and clearly explain how fees and expenses are charged including, but not limited to, the following: how billable hours are calculated and the rates charged per hour for the services of the lawyers or staff members who will work on the client's matter; if some other method of billing is used, such as value billing, how the fee will be determined; and the expenses for which the client will be liable and how the cost of those expenses will be determined.

Note that the following paragraphs contain suggested or recommended language. Lawyers are not required to use these model fee provisions.

Model Fee Provisions

Advance Payment

As a condition of the employment of Lawyer, Client agrees to deposit $_____ in the client trust account maintained by Lawyer's firm. This money is a deposit securing payment for the legal work for Client that will be performed by Lawyer and his/her staff. Legal work will be billed on an hourly basis [or other appropriate basis] according to the schedule attached to this agreement. Client specifically authorizes Lawyer to withdraw funds from Client's deposit in the trust account when payment is earned by the performance of legal services for Client. When the deposit is exhausted, Lawyer reserves the right to require further reasonable deposits to secure payment. Lawyer will provide Client with a [monthly, quarterly, etc.] accounting [upon request] for legal services showing the legal fees earned and payment of the fees by withdrawal against Client's deposit in the trust account. Client should notify Lawyer immediately if Client retracts his/her consent to the withdrawal of money from Client's deposit in the trust account to pay for legal services. When Lawyer's representation ends, Lawyer will provide Client with a written accounting of the fees earned and costs incurred, and a refund of any unearned portion of the deposit that remains in the trust account [less expenses associated with the representation].

General Retainer

As a condition of the employment of Lawyer, Client agrees to pay $____ to Lawyer. This money is a*general retainer* paid by Client to ensure that Lawyer is available to Client in the event that legal services are needed now or in the future and to insure that Lawyer will not represent anyone else relative to Client's legal matter without Client's consent.

Client understands and specifically agrees that:

- *the general retainer is not payment for the legal work to be performed by Lawyer;*

- *Client will be billed separately for the legal work performed by Lawyer* and his/her staff. Legal work will be billed on an hourly basis [or other appropriate basis] according to the schedule attached to this agreement;

- the general retainer will be earned by Lawyer immediately upon payment and *will be deposited in Lawyer's business account rather than a client trust account*; and

- when Lawyer's representation ends, *Client will not be entitled to a refund of any portion of the general retainer* unless it can be demonstrated that the general retainer is clearly excessive under the circumstances.

Flat Fee (or Prepaid Flat Fee)

As a condition of the employment of Lawyer, Client agrees to pay $_____ to Lawyer as a *flat fee* for the following specified legal work to be performed by Lawyer for Client: [description of legal work]

Client understands and specifically agrees that:

- *the flat fee is the entire payment for the specified legal work to be performed by Lawyer* regardless of the amount of time that it takes Lawyer to perform the legal work;

- the flat fee will be earned by Lawyer immediately upon payment and *will be deposited in Lawyer's business account rather than a client trust account*; and

- when Lawyer's representation ends, *Client will not be entitled to a refund of any portion of the flat fee* unless (1) the legal work is not completed, in which event a proportionate refund may be owed, or (2) it can be demonstrated that the flat fee is clearly excessive under the circumstances.

Minimum Fee

As a condition of the employment of Lawyer, Client agrees to pay $_____ to Lawyer. This money is a*minimum fee* for the reservation of Lawyer's services; to insure that Lawyer will not represent anyone else relative to Client's legal matter without Client's consent; and for legal work to be performed for Client.

Client understands and specifically agrees that:

- the minimum fee will be earned by Lawyer immediately upon payment and *will be deposited in Lawyer's business account rather than a client trust account*;

- Lawyer will provide legal services to Client on an hourly basis [or other appropriate basis] according to the schedule attached to this agreement until the value of those services is equivalent to the minimum fee; *thereafter, Client will be billed for the legal work performed by Lawyer* and his/her staff on an hourly basis [or other appropriate basis] according to the schedule attached to this agreement; and

- when Lawyer's representation ends, *Client will not be entitled to a refund of any portion of the minimum fee, even if the representation ends before Lawyer has provided legal services equivalent in value to the minimum fee*, unless it can be demonstrated that the minimum fee is clearly excessive fee under the circumstances.

2006 FORMAL ETHICS OPINION 8

DISBURSEMENT OF TRUST FUNDS

Adopted: July 21, 2006

Opinion rules thata lawyer may disburse against deposited items in reliance upon a bank's fundingschedule under certain circumstances.

Inquiry:

Attorney receivesinsurance company checks for payment of workers' compensation and personalinjury settlements. Upon receipt, Attorney deposits these checks into her trustaccount. Because the insurance checks are not among the identified instrumentsin the Good Funds Settlement Act, G.S. §45A-4, she must wait until the fundshave been "irrevocably credited" or collected before disbursing from the trustaccount to the client. RPC 191. Attorney has been unable to locate a bank thatis willing to confirm when deposited funds have been collected.

Attorney hasconsulted with other lawyers in her locality with similar practices. Rather thancall the bank to confirm that the funds have been collected, the lawyersroutinely disburse against items deposited in the trust account, based uponprior dealings with the banks, in accordance with the following fundingschedule: 3 business days for an in-state check and 7 business days for anout-of-state check. Attorney would like to follow this funding or "float"schedule for disbursements, as it appears to be the standard in her community.

May Attorneydisburse funds from her trust account in reliance upon this schedule?

Opinion:

RPC 191 permitslawyers to disburse immediately from the trust account in reliance upon thedeposit of funds provisionally credited to the account if the funds are in theform of cash, wired funds, or one of the enumerated instruments listed in theGood Funds Settlement Act. For all other instruments, a lawyer has anobligation to conduct reasonable due diligence to determine whether fundsdeposited into the trust account have been collected prior to disbursement.

Initially, a lawyeralways should consult with her bank to determine when a particular instrumenthas been collected or funded. Before disbursing, a lawyer should also considerthe source of the funds, i.e., whether the payor is reputable and whether the instrumentis likely to be honored. If a lawyer receives confirmation by the bank that thefunds deposited are collected, then the lawyer may rely upon this informationand disburse against the funds. A lawyer reasonably may rely upon her bank'sfunding or "float" schedule or policy *only* when the lawyer is unable to confirm whether fundshave been irrevocably credited to his account and he has no reason to believe aparticular instrument will not be honored under the circumstances. In any case,if the lawyer subsequently learns that an instrument has been dishonored, thelawyer must act immediately to protect other trust account property bypersonally paying the amount of any failed deposit or arranging for paymentfrom other sources. "An attorney should take care not to disburse againstuncollected funds in situations where the attorney's assets or credit would beinsufficient to fund the trust account checks in the event that an... item isdishonored." RPC 191.

Therefore, ifAttorney is unable to confirm that a particular insurance check has beencollected, she may reasonably rely upon and disburse in accordance with herbank's funding schedule as long as 1) she reasonably believes the trust accountcheck will be honored, and 2) she is able to fund the check in the event it isultimately dishonored.

2001 FORMAL ETHICS OPINION 3

DISBURSEMENT FOR TORT CLAIM SETTLEMENT UPON DEPOSIT OF FUNDS PROVISIONALLY CREDITED TO TRUST ACCOUNT

Adopted: April 27, 2001

Opinion rules that a lawyer may settle a tort claim by making disbursements from a trust account in reliance upon the deposit of funds provisionally credited to the account if the deposited funds are in the form of a financial instrument that is specified in the Good Funds Settlement Act, G.S. Chap. 45A.

Inquiry #1:

Attorney regularly represents individuals with personal injury claims. When an insurance company check for $5000 or more is paid in settlement of a client's claim, the check is deposited into the trust account of Attorney's firm. No disbursements are made to the client, or to third parties on behalf of the client, until the funds are actually collected because RPC 191 limits the disbursements that can be made against provisional credit. RPC 191 prohibits a lawyer from making disbursements from a trust account unless the funds are actually on deposit in the account or, if the depository institution grants provisional credit, unless the financial instrument deposited into the account is one of the ones specified in the Good Funds Settlement Act, G.S. Chap. 45A (the "Act").

Attorney believes that RPC 191 should not apply to disbursements from a trust account for a personal injury settlement because the Act is specifically limited to the settlement of residential real estate transactions. See G.S. §45A-2. Attorney believes that the limitations of RPC 191 create a hardship on his firm and the client because the client has to come to the firm's office to endorse the settlement check and, after the check clears the bank, return to the firm to collect the disbursement. This may have an adverse effect on a client's credit and delay repairs to or replacement of an automobile if there is also a property damage settlement. It also costs Attorney additional time to meet with the client twice.

Is RPC 191 applicable to personal injury settlements? If so, is there an exemption for personal injury settlements or checks from insurance companies licensed to do business in North Carolina?

Opinion #1:

RPC 191 is applicable to all disbursements from a trust account against financial instruments that are not irrevocably credited to the account upon deposit although the Good Funds Settlement Act was adopted by the General Assembly only to regulate the settlement of residential real estate transactions. The rationale for the opinion is found in the following excerpt from the opinion:

Notwithstanding the fact that some of the forms of funds designated in the Act are not irrevocably credited to the lawyer's trust account at the time of deposit, the risk of noncollectibility is so slight that a lawyer's disbursement of funds from a trust account in reliance upon the deposit into the account of provisionally credited funds in these forms shall not be considered unethical. However, a closing lawyer should never disburse against any provisionally credited funds unless he or she reasonably believes that the underlying deposited instrument is virtually certain to be honored when presented for collection. A lawyer may immediately disburse against collected funds, such as cash or wired funds, and may immediately make disbursements from his or her trust account in reliance upon provisional credit extended by the depository institution for funds deposited into the trust account in one or more of the forms set forth in G.S. §45A-4.

The disbursement of funds from a trust account by a lawyer in reliance upon provisional credit extended upon the deposit of an item into the trust account which does not take one of the forms prescribed in the Act constitutes professional misconduct, regardless of whether the item is ultimately honored or dishonored.

The exception allowed in RPC 191 to the duty to disburse only against collected funds in a trust account is purposefully narrow to limit the potential for disbursements against instruments that are subsequently dishonored. If an instrument is subsequently dishonored, it puts at risk all client funds on deposit in the trust account. The relatively minor inconvenience of waiting for a check to clear the bank is offset by the protection that disbursement against collected funds provides to all clients with funds deposited in the trust account. The General Assembly, as a matter of public policy, has determined that the items set forth in the Good Funds Settlement Act are sufficiently reliable to exempt these items from the safeguard awaiting to collect the funds but the Ethics Committee of the State Bar does not have the authority to expand the exemption.

Inquiry #2:

When Attorney settles a property damage claim on a client's vehicle, he asks the insurance company to put only the name of the client on the settlement check. Attorney believes that this is the only way that the check can be given directly to the client. If the check is made out to both the client and the law firm, Attorney deposits the check into the trust account and waits until the check is collected before disbursing the entire

amount of the check to the client. The delay before disbursement can be a serious inconvenience to a client who needs an automobile for transportation.

If an insurance check is made out jointly to the law firm (or Attorney) and the client, may Attorney endorse the check and give the check to the client without depositing it first into the trust account?

Opinion #2:

When funds belonging presently or potentially to a lawyer are received in combination with funds belonging to a client, or other persons, the funds must be deposited in tact into the trust account. See Rule 1.15-2(g). However, if all of the funds represented by a check from a third party belong to the client or the lawyer is prepared to forgo being paid for his legal services from the check proceeds (and bill the client instead), the check may be endorsed directly to the client without being deposited into the trust account.

RPC 191

DISBURSEMENTS UPON DEPOSIT OF FUNDS PROVISIONALLY CREDITED TO TRUST ACCOUNT

Adopted: October 20, 1995

Opinion rules that a lawyer may make disbursements from his or her trust account in reliance upon the deposit of funds provisionally credited to the account if the funds are deposited in the form of cash, wired funds, or by specified instruments which, although they are not irrevocably credited to the account upon deposit, are generally regarded as reliable.

Revised January 24, 1997

Editor's Note: RPC 191 originally became a formal opinion of the State Bar on October 20, 1995. The opinion sets forth the duty of a closing lawyer to disburse from the trust account only in reliance upon the deposit of specified negotiable instruments which have a low risk of noncollectibility. On June 21, 1996, the North Carolina General Assembly ratified the Good Funds Settlement Act, G.S. Chapter 45A, which became effective October 1, 1996. The act sets forth the duty of a settlement agent for a residential real estate closing to disburse settlement proceeds from a trust or escrow account only in reliance upon the deposit of specified negotiable instruments. There was some inconsistency between the list of negotiable instruments against which disbursement was permitted in the Act and a similar list in RPC 191. To correct this, RPC 191 was revised to reference the list of acceptable negotiable instruments found in the Act.

Introduction:

In the wake of the financial failure of an out-of-state mortgage lender, the State Bar received numerous requests to reexamine prior ethics opinions CPR 358 and RPC 86 which permitted a lawyer to issue trust account checks against funds which, although uncollected, were provisionally credited to the lawyer's trust account by the financial institution with which the trust account was maintained. RPC 86 cautioned that the closing lawyer should disburse against provisionally credited funds only when the lawyer reasonably believed that the underlying deposited instrument was virtually certain to be honored when presented for collection. Nevertheless, lawyers did accept, deposit, and disburse against the residential loan proceeds checks of the out-of-state mortgage lender that failed. Some of these checks were ultimately dishonored and charged back against the trust accounts of the closing lawyers. In the meantime, some trust account checks issued for the closings were presented for collection and paid, resulting in the use of funds deposited by other clients to pay the closing checks presented for payment.

Inquiry:

In the typical residential real estate closing, the lending institution that finances the purchase of the property delivers the loan proceeds to the closing lawyer in the form of a check drawn upon a financial institution which may or may not be located in North Carolina. Loan proceeds are seldom delivered to the closing lawyer in the form of wired funds. Similarly, the real estate agent sometimes delivers the earnest money to the closing lawyer in the form of a check drawn on his or her trust account and the buyer sometimes delivers a personal check to the closing lawyer to cover the difference between the loan amount and the buyer's obligations. May a closing lawyer deposit such checks in his or her trust account and, if the depository bank will provisionally credit the lawyer's trust account, immediately disburse against the items before they have been collected?

Opinion:

Yes, but only upon the conditions set forth in this opinion.

A lawyer (1) may disburse funds from a trust account only in reliance upon the deposit of a financial instrument specified in the Good Funds Settlement Act, G.S. Chap. 45A (the Act), which became effective on October 1, 1996, and the securing of provisional credit for the deposited item, and (2) as an affirmative duty, must immediately act to protect the property of the lawyer's other clients by personally paying the amount of any failed deposit or securing or arranging payment from other sources upon learning that a deposited instrument has been dishonored. It shall be unethical for a lawyer to disburse funds from a trust account in reliance upon the deposit of a financial instrument that is not specified in the Act, regardless of whether the item is ultimately honored or dishonored.

In reliance on CPR 358 and RPC 86, many closing lawyers deposit the checks from the lender, the real estate agent, and the buyer into their trust accounts, receive provisional credit for the items from the depository bank and immediately disburse funds from their trust accounts in accordance with the schedule of receipts and disbursements prepared for the closing. There is typically some delay, generally three to four days but in some instances as much as fifteen days, between the time of the deposit of the checks of the lender, the buyer, and the real estate agent into the lawyer's trust account and the time when the funds are irrevocably credited to the lawyer's trust account by the depository

institution. Because of the time lag between the deposit and the collection of the checks, the closing lawyer runs the risk that a check may be ultimately dishonored and charged back against the trust account of the closing lawyer, resulting in the use of the funds of other clients on deposit in the trust account to satisfy the disbursement checks from the closing.

A lawyer who receives funds that belong to a client assumes the responsibilities of a fiduciary to safeguard those funds and to preserve the identity of the funds by depositing the funds into a designated trust account. Rule 10.1 of the Rules of Professional Conduct. It is a lawyer's fiduciary obligation to ensure that the funds of a particular client are used only to satisfy the obligations of that client and are not used to satisfy the claims of the lawyer's creditors. Rule 10.1 and comment. Furthermore, Rule 10.2 of the Rules of Professional Conduct requires a lawyer to maintain complete records of all funds or other property of a client received by the lawyer and to render to the client appropriate accountings of the receipt and disbursement of any of the client's funds or property held by the lawyer. Rule 10.2(e) recognizes a lawyer's obligation to pay promptly or deliver to the client, or to a third person as directed by the client, the funds in the possession of the lawyer to which the client is entitled. Strictly interpreted, these rules would appear to require a lawyer not to disburse upon items deposited in his or her trust account until the depository bank has irrevocably credited the items to the account.

Requiring a closing lawyer to postpone disbursement until all items have been credited to the lawyer's trust account would result in inconvenience, delay, and could have an adverse effect on the economy. Nevertheless, there is some risk that certain instruments, such as ordinary commercial checks, may be uncollectible in any given transaction. Conversely, there are financial instruments that are generally regarded as extremely reliable. In fact, other state bars that have considered the issue have held that there are certain financial instruments for which the risk of noncollectibility is so slight as to make it unnecessary to prohibit a closing lawyer from disbursing immediately against such items before they are collected. See Virginia State Bar Legal Ethics Opinion 183 and Rule 5-1.1(g) of the Rules Regulating the Florida Bar. Similarly, the North Carolina Good Funds Settlement Act permits a "settlement agent," or person responsible for conducting the settlement and disbursement of the proceeds for a residential real estate closing, to disburse against uncollected funds but only if the deposited instrument is in one of the forms specified in the Act.

Notwithstanding the fact that some of the forms of funds designated in the Act are not irrevocably credited to the lawyer's trust account at the time of deposit, the risk of noncollectibility is so slight that a lawyer's disbursement of funds from a trust account in reliance upon the deposit into the account of provisionally credited funds in these forms shall not be considered unethical. However, a closing lawyer should never disburse against any provisionally credited funds unless he or she reasonably believes that the underlying deposited instrument is virtually certain to be honored when presented for collection. A lawyer may immediately disburse against collected funds, such as cash or wired funds, and may immediately make disbursements from his or her trust account in reliance upon provisional credit extended by the depository institution for funds deposited into the trust account in one or more of the forms set forth in G.S. §45A-4.

The disbursement of funds from a trust account by a lawyer in reliance upon provisional credit extended upon the deposit of an item into the trust account which does not take one of the forms prescribed in the Act constitutes professional misconduct, regardless of whether the item is ultimately honored or dishonored. However, a lawyer who disburses in reliance upon provisional credit extended upon the deposit of an item prescribed in the Act shall not be guilty of professional misconduct if that lawyer, upon learning that the item has been dishonored, immediately acts to protect the property of the lawyer's other clients by personally paying the amount of any failed deposit or securing or arranging payment from sources available to the lawyer other than trust account funds of other clients. An attorney should take care not to disburse against uncollected funds in situations where the attorney's assets or credit would be insufficient to fund the trust account checks in the event that a provisionally credited item is dishonored.

To the extent that CPR 358 and RPC 86 are inconsistent with this opinion, they are overruled. However, there are provisions in both opinions that remain operative. Specifically, the provision of CPR 358 that prohibits a lawyer from disbursing against the " in the trust account during the time lag between the deposit of the checks of the lender, the buyer, and the real estate agent and the time when these items are irrevocably credited to the account unless provisional credit for the items is extended by the depository institution remains in effect. If provisional credit is not extended by the depository institution, the disbursing lawyer is using the funds of other clients to cover the closing disbursements until the deposited items are collected in violation of Rule 10.1.

It should be emphasized that this opinion shall apply to any disbursements from the trust account against items which are not irrevocably credited to the account upon deposit, whether such disbursements are for the purpose of closing a real estate transaction or for the purpose of concluding some other transaction or matter.

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CREDIT CARD CHARGEBACKS AGAINST A TRUST ACCOUNT

Adopted: January 16, 1998

Opinion rules that, provided steps are taken to safeguard the client funds on deposit in a trust account, a lawyer may accept fees paid by credit card although the bank's agreement to process such charges authorizes the bank to debit the lawyer's trust account in the event a credit card charge is disputed by a client.

Inquiry #1:

To accept charges paid by MasterCard and Visa credit cards, as well as other national credit cards, a lawyer must enter into a standard form "Merchant Agreement" with a bank in which the bank agrees to deposit credit card payments from cardholders electronically into the merchant's account with the bank subject to certain conditions. Among other conditions, such agreements typically permit the bank to debit a merchant's account for the discount fee, or the bank's charge to the merchant for advancing the credit card payments. In addition, such agreements typically permit the bank to "charge back" the merchant's bank account, without prior notice, in the amount of a prior payment by credit card which is subsequently disputed by the cardholder. The dispute process is commenced when the cardholder notifies the credit card issuer that he disputes a charge shown on his statement. The merchant is notified of the dispute. Documentation of the charge is requested from the merchant. If the documentation is not deemed satisfactory or the merchant fails to respond, the bank may debit the disputed amount from the merchant's account with the bank without prior notice to the merchant.

Lawyers may accept payment of legal fees by electronic transfer and credit card. CPR 129 and RPC 247. However, RPC 247 requires a lawyer to arrange to have all credit card payments electronically deposited into the trust account if the lawyer's bank cannot or will not distinguish between the operating account, into which earned fees should be deposited, and the trust account, into which unearned fees should be deposited. To avoid the problem of commingling the funds of clients and the lawyer's funds, the opinion provides:

> [i]f a payment by electronic transfer of an earned fee cannot be distinguished by the bank from a payment by electronic transfer of an unearned fee, all payments by electronic transfer should be deposited into a lawyer's trust account and earned fees should be withdrawn from the trust account promptly. [Citing now repealed Rule 10.1(c).] The lawyer may also deposit into the trust account funds sufficient to pay the bank's service charges for electronic transfers. [Citing now repealed Rule 10.1(c)(1).] A ledger should be maintained for the service charges posted against such funds. [Citing now repealed Rule 10.2(c)(3).]

According to RPC 247, all payments of unearned fees and expenses must be deposited into a lawyer's trust account even if the payment is made by credit card. May a lawyer participate in a merchant agreement with a bank to honor credit card charges if the agreement gives the bank the authority to debit the lawyer's trust account for a chargeback without prior notice to the lawyer?

Opinion #1:

Yes, provided the lawyer takes appropriate steps to protect the funds of other clients on deposit in the trust account.

A lawyer who receives funds that belong to a client assumes the responsibilities of a fiduciary to safeguard those funds and to preserve the identity of the funds by depositing them into a designated trust account. Rule 1.15-1 of the Revised Rules of Professional Conduct and RPC 191. The responsibilities of a fiduciary include the duty to ensure that the funds of a particular client are used only to satisfy the obligations of that client and are not used to satisfy the claims of the lawyer's creditors or of other clients of the lawyer. RPC 191. Therefore, a lawyer may participate in a merchant agreement with a bank to honor the credit card payments of clients only if the funds of other clients on deposit in the lawyer's trust account will be protected against a chargeback.

To avoid the potential jeopardy to the funds of other clients on deposit in a trust account, the lawyer must first attempt to negotiate an agreement with the bank that requires the bank to debit an account other than the trust account in the event of a chargeback. Some banks will route chargeback debits (and the discount fee for credit card charges) against a firm's operating account. Some banks may require a merchant to maintain a separate demand deposit account in an amount sufficient to cover chargebacks. If a bank cannot or is unwilling to debit a separate account, (i.e., the bank requires all chargebacks to be debited from the account into which credit card payments are deposited), the lawyer must request that the bank arrange an inter-account transfer such that the lawyer's operating account, or other non-trust account, will be immediately debited in the event of a chargeback against the trust account and the money promptly deposited into the trust account to cover the chargeback. If the bank will not agree to debit another account or arrange for inter-account transfers, the lawyer must establish a trust account for the sole purpose of receiving advance payments by credit card. The lawyer must withdraw all payments to this trust account immediately and deposit them in the lawyer's "primary" trust account. In this way, the risk that a chargeback will impact the funds of other clients will be minimized.

Under all circumstances, a lawyer is ethically compelled to arrange for a payment (from his or her own funds or from some other source) to the trust account sufficient to cover the chargeback in the event that a chargeback jeopardizes the funds of other clients on deposit in the account.

Inquiry #2:

May a lawyer participate in a merchant agreement that grants the bank a security interest in the accounts that the lawyer maintains with the bank?

Opinion #2:

No, Rule 1.15-1(g) prohibits the use or pledge of funds in a trust account to obtain credit. If one or more of the accounts is a trust account, the lawyer may not participate in the agreement unless the trust account or accounts are specifically exempted from the grant of a security interest.

Inquiry #3:

If the nature of a lawyer's practice is such that all fees that the lawyer collects are earned at the time of collection, may the lawyer arrange for payments by credit card to be made directly to the lawyer's operating account?

Opinion #3:

Yes. Rule 1.15-1.

Endnote

1. The Truth in Lending Act (§170, 15 USC §1666i) and Regulation Z (12 CFR §226.12(c)) contain provisions which preserve a cardholder's claim and defenses against a card issuer in certain circumstances. A cardholder is given a right to assert against the card issuer all claims (other than tort claims) and defenses arising out of the credit transaction that it would otherwise have against the merchant. Regulation Z does not provide any guidance as to the nature of the claims and defenses that may be asserted. Since it does give the cardholder the right to assert against the card issuer any claims and defenses available that would be available against the merchant, however, most merchant agreements provided for a "pass through" of the problem. The power of a cardholder to reverse a credit card transaction is very broad. The following is the mandatory disclosure that must appear in the credit card agreement with a prospective cardholder: If you have a problem with the quality of property or services that you purchased with a credit card, and you have tried in good faith to correct the problem with the merchant, you may have the right not to pay the remaining amount due on the property or services. There are two limitations on this right: (A) You must have made the purchase in your home state, if not within your home state, within 100 miles of your current mailing address; and (B) The purchase price must have been more than $50.00. These limitations do not apply if the card issuer owns or operates the merchant or if we mailed you the advertisement for the property or services (Regulation Z, App. G-3).