

**New York State Bar Association
Committee on Professional Ethics**

Opinion 1127 (7/7/17)

Topic: Attorney Escrow Account; Attorney Special Account; Attorney Trust Account

Digest: Settlement proceeds must be deposited into an attorney's Special Account and must be promptly paid to clients and to third persons to the extent such persons have an ownership interest in the settlement proceeds. Where a third person does not possess such an interest, but has only a claim against the lawyer, the lawyer may choose to pay such amounts either from the Special Account or from the attorney's operating account. Payment to the law firm of legal fees and expenses must be transferred from the Special Account to the firm's operating account by check or bank transfer.

Rules: 1.15(a), (b), (c) & (e)

FACTS

1. A lawyer has received a settlement check that includes the funds due to the client and the funds due to the firm for its legal fees and expenses. The firm may be obligated to share its legal fees with a referring attorney or to pay a portion of the fees, as a bonus, to a staff attorney who was responsible for bringing the matter to the firm. The settlement check has been deposited in the firm's Special Account. Once the check clears, the firm intends to disburse the funds to others.

QUESTIONS

2. A. When a law firm receives settlement funds, may or must the law firm distribute, directly from the firm's Special Account, the funds over and above those owed to the client, including amounts owing (i) to the referring attorney as a referral fee, (ii) to a staff attorney as a bonus, and (iii) to the law firm in payment of the firm's legal fees and expenses, or may or must the firm instead first transfer the settlement funds to the firm's operating account for further distribution?

B. How quickly must the distributions be made?

OPINION

3. Rule 1.15(a) prohibits a lawyer from commingling funds belonging to another person with funds of the lawyer. Rule 1.15(a) provides:

A lawyer in possession of any funds or other property belonging to another person, where such possession is incident to his or her practice of law, is a fiduciary, and must not misappropriate such funds or property or commingle such funds or property with his or her own.

Rule 1.15(b) requires that funds belonging to the client or another person be maintained in a special account or accounts (the "Special Account"), sometimes referred to as an "attorney trust account" or "attorney escrow account." *See* Rule 1.15(b)(2).

4. Whether the funds from a settlement check that the lawyer will use to pay third persons must be paid from the Special Account depends on the meaning of the phrase "funds belonging to another person" in Rule 1.15(a). If the lawyer or the client has entered into a contract obligating the lawyer to pay a third person from the proceeds of the settlement, or if such right is granted by law, then some of the proceeds of the settlement check "belong" to such person, and the payments to such person must be made from the Special Account. *See* N.Y. State 717 (1996) (construing the phrase

“entitled to receive the funds” in the predecessor to what is now Rule 1.15(c)(1) to include medical providers who have valid assignments or liens against proceeds, but excluding other unsecured creditors). They may not be transferred to the lawyer’s operating account because a lawyer may not commingle funds “belonging” to others with the lawyer’s own funds.

5. If the third person does not have a legal right to receive the proceeds of the settlement check, the third person may have a claim against the lawyer for the amounts owed. In this situation, where the settlement funds do not “belong” to the third person but the third person may have a claim against the lawyer for a portion of the funds, the lawyer has a choice. The lawyer may leave the amounts owed to the third person in the Special Account and pay the third person directly from that account. Alternatively, the lawyer may transfer the amount owed to the third person to the lawyer’s operating account and make payments to the third person by writing checks on (or, where authorized, making bank transfers from) the operating account.

6. In many situations, a lawyer will owe money to third persons but will not have transferred an interest in the settlement proceeds. For example, amounts owed by the lawyer for rent, salaries and the expenses of third party suppliers are all legal obligations of the lawyer or law firm but do not give the landlord or employees or vendors a legal interest in specific settlement proceeds. Many lawyers will choose to pay such amounts from their operating accounts because it may be easier to keep track of payments from the operating account.

7. If a client or third person has a legal interest in funds in the Special Account, the lawyer must “promptly notify” the client or third person of the receipt of funds in which such person has an interest. Rule 1.15(c)(1). The lawyer also must “promptly pay” the funds to the person to whom the funds belong. *See* Rule 1.15(c)(4), N.Y. State 946 (2012). “Promptly” means within hours or days, not weeks. Although written notice is not required, it is the best means to ensure a record exists to confirm that the lawyer has met the requirements of Rule 1.15(c)(1). *See* Roy Simon, *Simon's New York Rules of Professional Conduct Annotated* 903 (Thomson Reuters 2016). If a person does not have a legal interest in the property in the Special Account, Rule 1.15(c)(1) does not apply. In that case, the timing of the lawyer’s payment obligation is a matter of contract that is outside the Committee’s jurisdiction.

8. Whether the lawyer pays the third person directly from the Special Account or instead first transfers the amount claimed by the third party into the lawyer’s operating account, the lawyer must wait for the settlement check to clear before disbursing any of the funds. *See* N.Y. State 737 (2001) (lawyer may not draw on funds belonging to Client A for the benefit of Client B). *See also In Re Sukhdeo*, 47 A.D.3d 6 (2d Dept. 2007), *In Re Rosenberg*, 3 A.D.3d 52 (2d Dept. 2003), *In Re Rudlin*, 280 A.D.2d 200 (4th Dept. 2001). To do otherwise would result in a technical conversion because the lawyer would be using cleared funds belonging to others to cover the pending checks drawn on the uncleared settlement check.

9. As to the amount owed to the lawyer for legal fees and expenses, Rule 1.15(b)(4) states that funds belonging in part to a client or third person and in part currently or potentially to the lawyer must be kept in the Special Account, but when the portion belonging to the lawyer is not in dispute, “the portion belonging to the lawyer or law firm may be withdrawn when due unless the right of the lawyer or law firm to receive it is disputed by the client or third person, in which event the disputed portion shall not be withdrawn until the dispute is finally resolved.” Transfers from the Special Account to the lawyer’s operating account may be made by check or by bank transfer. Rule 1.15(e).

CONCLUSION

10. Settlement proceeds in which a client or third person has an ownership interest must be paid to such persons from the attorney’s Special Account. Where a third party does not possess such an

ownership interest, but has a claim only against the lawyer personally, the lawyer may opt to pay such amounts either directly from the Special Account or from the attorney's operating account. Payment to the law firm of legal fees and expenses must be transferred to the firm's operating account by check or bank transfer.

(16-17)