New York State Bar Association

Committee on Professional Ethics

Opinion 737 (2/1/01)

Topic: Escrow accounts

Digest: A lawyer may not issue a check from an attorney escrow account drawn against a bank or certified check that has not been deposited or has not cleared.

Code: DR 9-102

QUESTION

In payment of a client's obligations to a third party, may a lawyer issue an attorney escrow check against undeposited or uncleared client funds delivered to the lawyer in the form of a bank or certified check?

OPINION

Disciplinary Rule (DR) 9-102 establishes the framework for how lawyers must handle clients' funds. For example, DR 9-102(A) provides that a lawyer is a fiduciary with respect to the client whose funds are maintained in the lawyer's escrow account and prohibits the lawyer from commingling such funds with the lawyer's own. DR 9-102(B)(1) requires a lawyer to maintain an escrow account for client funds "separate from any business or personal accounts of the lawyer or the lawyer's firm, and separate from any accounts which the lawyer may maintain as executor, guardian, trustee or receiver, or in any other fiduciary capacity." DR 9-102(C)(4) requires a lawyer to promptly pay to the client from escrow those funds which the client is entitled to receive. DR 9-102(D) requires certain bookkeeping records be maintained for escrow accounts which, pursuant to subdivision (1) thereof, "specifically identify the date, source and description of each item deposited, as well as the date, payee and purpose of each withdrawal or disbursement."

Implicit in this framework is that a lawyer will not draw on funds belonging to Client A for the benefit of Client B. Yet this is literally what occurs where a lawyer maintains funds belonging to multiple clients in a single unsegregated

escrow account and issues a check in payment of the obligation of one client before certified checks or bank checks delivered to the attorney's possession for the benefit of that client in amounts sufficient to cover that obligation are deposited into the lawyer's escrow account and cleared. The issue before this Committee is whether there are practical considerations which, with appropriate safeguards, may permit a relaxation of the ethical proscription against a lawyer, in effect, granting Client B a temporary loan out of funds belonging to Client A.

The issue arises most often in the context of residential real estate closings. In many parts of the State, the seller's attorney or a real estate broker typically holds funds from the buyer in an escrow account. The amount, which in some transactions may be as much as ten percent of the purchase price, represents the buyer's down payment delivered upon execution of a residential purchase contract. This down payment — cleared by the time of closing — may be sufficient for the seller's closing obligations if there is adequate pre-closing planning and communication between the attorneys for the seller, the attorneys for the purchaser and the attorneys for the purchaser's lending institution concerning the correct closing figures and the manner of the purchaser's payment of the balance due. Sometimes, however, open taxes, open judgments or other liens will first appear in a continuation title search run immediately prior to or at the closing in amounts that exceed the funds already cleared and in escrow. As these encumbrances constitute a cloud on title that must be cleared at the closing in order for the seller to convey good title, the purchaser's title agent must be given adequate funds from or on behalf of the seller to cure the problem or to omit them from the title commitment. For this purpose, only a bank check, a certified check or an attorney's check will typically be accepted.

In these circumstances — where the earnest money or down payment deposited and cleared in escrow is insufficient to satisfy the seller's closing obligations and where bank or certified checks in the proper amounts are not available at the closing — it might seem that a practical solution to avoid the delay, inconvenience and expense of an adjournment would be for the seller's attorney to accept for deposit in his or her escrow account the bank or certified checks tendered by the purchaser or the purchaser's lender for the balance of the purchase price, checks usually made payable to the seller, which the seller then endorses over to the seller's attorney for deposit in the escrow account. The seller's attorney would then issue checks drawn on the escrow account payable in the amounts required to satisfy the seller's closing obligations, including the open taxes, judgments or other liens that encumber the good title that the seller is contractually obligated to convey, and remits the balance of the proceeds to his or her client. Apparently, the title companies and others will accept the escrow check of the seller's attorney, notwithstanding actual knowledge that the bank checks and certified checks delivered to the seller's attorney at the closing have not yet been deposited into the attorney's escrow account and, perforce, have not yet cleared. The seller's attorney is often willing to issue such escrow checks because there are sufficient funds, already cleared

on deposit in the attorney's escrow account, to cover the checks issued at the closing. To the extent the total amount of the escrow checks issued at closing thus exceeds the buyer's down payment or earnest money, the funds on deposit in the attorney's escrow account that are used to cover the excess are indisputably funds belonging to other clients.

There are a number of arguments that can be advanced in favor of interpreting DR 9-102 to allow a lawyer to issue escrow checks on behalf of Client B that are covered by cleared funds in the same escrow account deposited on behalf of Client A where the lawyer is in physical possession of bank or certified checks appropriately endorsed for deposit into the lawyer's escrow account on behalf of Client B that, if and when cleared, would be sufficient to cover those escrow checks. Some of these arguments have been favorably considered by the authorities in other states. Thus, Florida and Illinois have adopted specific rules permitting lawyers to disburse uncleared funds. *See* Rule 1.15 of the Illinois Rules of Professional Conduct; Rule 5-1.1(g) of the Rules Regulating the Florida Bar. In addition, New Jersey, North Carolina, and Virginia have approved of the practice, *see* N.J. Eth. Op. 454 (1980), N.C. Eth. Op. RPC 191 (1997), and Va. Eth. Op. 183 (1996), while South Carolina has not. *See In re Hensel*, 2000 WL 640239 (S.C. Sup. Ct. May 15, 2000), S.C. Adv. Op. 78-20 (1978). On balance, however, we find none of the arguments sufficiently persuasive to subvert the obvious intended core purpose of DR 9-102 — to maintain the integrity of a client's funds for the benefit of that client only, until payment of those funds to, for or on behalf of that client and no other client, is due.

First, it can be argued that an attorney comes into "possession" of funds on behalf of Client B within the meaning of DR 9-102(A) when he or she receives the bank checks or certified checks properly endorsed for deposit into his escrow account on behalf of Client B at the closing. Because the risk that a certified check or bank check will not clear is considered to be negligible, it can be argued that the receipt should be analogized to the receipt of cash. However, even cash can be lost or stolen between the time of the closing and the time of the bank deposit, and until the cash is deposited and credited to the escrow account, the cash does not generate available funds. A bank or cashier's check may also be subject to a stop payment order if the check was procured by fraud. *See, e.g., U.S. Printnet, Inc. v. Chemung Canal Trust Co.,* 270 A.D.2d 544, 703 N.Y.S.2d 821, 823 (3rd Dept. 2000), and cases cited therein. In addition, the checks themselves may turn out to be forgeries. *See, e.g.*, *U.S. v. Van Shutters*, 163 F.3d 331 (6th Cir. 1998) (counterfeit bank checks were used to purchase automobiles) and *U.S. v. Werber*, 787 F. Supp. 353 (S.D.N.Y. 1992) (same). Finally, there has been at least one recent case where a fully licensed mortgage broker was unable to meet its obligations, defaulting on its own checks. *See* "New York State Banking Department Suspends Mortgage Banker's License," Press Release issued July 5, 2000 by NYS Banking Department, available at www.banking.state.ny.us.pr (visited 12/5/00).

Second, it is doubtless correct that bank checks and certified checks are ordinarily accepted as a proper tender of payment in business transactions and it is therefore argued to be unreasonable to hold an attorney to a higher standard in the administration of his escrow account. The commercial reasonableness of the practice, however, does not fairly address the situation where one client's funds are being used to cover the checks issued on behalf of another client. If a commercial party chooses to accept the minimal risk of loss associated with the acceptance of a bank check or certified check, that same party will bear any loss that actually comes to pass. However, if Client A's funds are used to cover the checks written by an attorney for the benefit of Client B, and the bank or certified check deposited after the checks are issued to cover Client B's obligations is for whatever reason unpaid, it is Client A, a stranger to the transaction, not Client B, a party to the transaction, who will suffer the loss.

Third, it may indeed be true that in most cases it is incidental closing expenses that will be paid if the subject practice is allowed and that, therefore, any loss, already a remote possibility, will likely be in a nominal amount. In the same vein, it is argued that prohibiting the practice will engender delay and inconvenience and may adversely affect the economy. Whether or not these are accurate statements of the risk and the peril seems, however, beside the point. If a client's funds may not be invaded for the benefit of another, the principle must hold no matter what the size or extent of the planned invasion and no matter what may be the detriment to third parties of withholding the use of that client's funds.

Fourth, the practice of writing escrow checks at a closing drawn on the funds of other clients and against undeposited or uncleared bank or certified checks, if prohibited as unethical, can be argued to have a greater adverse impact upon persons of moderate or low income. This is because, where the price of real estate in a given community is lower, the legal fees associated with the closings are often lower as well. There is more pressure upon attorneys who practice in these communities to generate fees on a volume basis and less time may be spent in preparing for closings generally with a view toward "working out" what title and other problems exist at that time. It is these attorneys who may be compelled to raise their fees in order to carry on their residential real estate practices if more pre-closing preparation time is required to satisfy ethical obligations. Alternatively, if additional pre-closing preparation time is eschewed in favor of an occasional adjournment of a closing in order to allow the seller additional time to clear an unexpected title objection or to allow the purchaser additional time to obtain a bank or certified check in a previously uncalculated or uncommunicated pay-off amount, this is still likely to result in additional cost to the parties, as the purchaser's lender will often charge a fee to adjourn a closing and the lender itself will often charge a fee to extend a loan commitment.

Although the Committee is sympathetic to the concerns of all parties to a residential real estate transaction who quite understandably would prefer to avoid the increased legal fees or costs that might be associated with an adjournment of a closing, these considerations are insufficient to overcome the fiduciary obligation that an attorney owes to the attorney's other clients whose funds must not be invaded.

Fifth, it has been suggested that Client A, by allowing his funds to be deposited in an unsegregated attorney escrow account has implicitly consented to the possibility that those funds might be drawn upon in behalf of a Client B, including the small risk that a bank or certified check deposited into the escrow account for the benefit of Client B might be dishonored. The implied consent is said to arise from knowledge of the widespread practice of attorneys writing escrow checks against undeposited or uncleared bank or certified checks. Far from assuming Client A's consent to the practice, this Committee would assume the very opposite — that Client A, if asked, would vigorously object to putting his funds at risk and granting a no-interest loan for the benefit of Client B with whom Client A shares neither a social nor a business bond.

Nor can we ascertain any conditions or qualifications to the issuance of attorney escrow checks against undeposited or uncleared bank or certified checks that might ethically purify the practice. For example, the practice has been found acceptable provided, among other things, that the attorney immediately makes good any loss. *See* N.C. Eth. Op. RPC 191 (1997). But if the attorney is personally willing to take the risk that the checks will not clear, we see no reason why the attorney should not simply advance the disbursements necessary to effect the closing out of his own operating account and await a refund from his escrow account if and when the bank or certified check clears. From a practical as well as a fiduciary perspective, it is far more appropriate for the attorney for both Client A and Client B to make a temporary, no-interest loan to Client A than it is for Client B to make such loan. The attorney has knowledge of the facts and circumstances pertaining to the closing and can evaluate the degree of risk associated with acceptance of the proffered bank or certified check. Client B, on the other hand, neither knows or controls anything and has consented to nothing.

Finally, we note that our conclusion appears to be in seeming conformance with several recent disciplinary determinations of the Appellate Division, Second Department, and we are unaware of any determinations of the First, Third or Fourth Departments which suggest a contrary result. *See Matter of Abbatine*, 263 A.D.2d 228, 700 N.Y.S.2d 211 (2d Dept. 1999) (five year suspension ordered for attorney who, *inter alia*, issued escrow check for $4,147.18 from unsegregated escrow account against $10,000 deposit made 16 days later); *Matter of Ferguson*, 259 A.D.2d 186, 694 N.Y.S.2d 113 (2d Dept. 1999) (one year suspension ordered for attorney who, *inter alia*, issued escrow check against "wired" funds not yet received); and *Matter of Joyce*, 236 A.D.2d

116, 119, 665 N.Y.S.2d 430, 431 (2d Dept. 1997) (indefinite suspension ordered for attorney who, *inter alia*, "[o]n at least four occasions...issued checks from his escrow account for a particular transaction in advance of depositing the subject funds into his escrow account, causing checks to clear against the funds of other clients or third parties").

CONCLUSION

The Committee welcomes further study of the problem addressed in this opinion with a view toward devising solutions that adhere to ethical requirements. However, for the reasons stated, the question is answered in the negative.

(22-00)