New York State Bar Association

Committee on Professional Ethics

Opinion 764 – 7/22/03

Topic: Escrow funds; fee agreements; conflicts of interest; Interest on Lawyer Account (IOLA)

Digest: Lawyer may only accept IOLA account earnings credit with consent of client after full disclosure

Code: DR 2-106(A), 5-101(A), 5-107(A)(2), 7-101(A)(3), 9-102(A); EC 2-21

QUESTION

May an attorney accept an earnings credit against bank charges based upon balances held in the attorney's IOLA account?

OPINION

A bank is developing a package of banking products designed specifically for attorneys that will include an "earnings credit" based on balances held in an attorney's operating accounts. Subject to this committee's approval, the earnings credit will also be given with respect to balances maintained in an attorney's IOLA account, but not with respect to non-IOLA attorney trust accounts. The earnings credit would only be applied to reduce or eliminate monthly bank fees otherwise chargeable to the attorney, and would not result in a cash payment or bank credit over and above the monthly bank fees. Because the bank would, in addition, waive the monthly maintenance fee associated with the IOLA account, the IOLA Fund would receive more money from IOLA accounts maintained by attorneys who have accepted the earnings credits than from other IOLA accounts.

IOLA accounts are unsegregated interest-bearing transaction accounts with check writing privileges. The interest on IOLA accounts is used to help finance legal services for the poor. The current IOLA interest rate paid by the bank state wide is .35 percent per annum. Pursuant to New York Judiciary Law §497(4)(c)(i) and (ii), "qualified funds" that are not deposited in an unsegregated IOLA account must be deposited in a segregated

interest-bearing attorney trust account for the client's benefit, or in an unsegregated interest-bearing attorney trust account provided the bank or the depositing lawyer can separately compute and pay to each client the interest earned by such client's funds.

"Qualified funds" are defined by Judiciary Law §497(2) as:

> moneys received by an attorney in a fiduciary capacity from a client or beneficial owner and which, in the judgment of the attorney, are too small in amount or are reasonably expected to be held for too short a time to generate sufficient interest income to justify the expense of administering a segregated account for the benefit of the client or beneficial owner. In determining whether funds are qualified for deposit in an IOLA account, an attorney may use as a guide the regulation adopted by the board of trustees of the IOLA fund pursuant to subdivision four of section ninety-seven-v of the state finance law.

The qualified funds determination "guideline" authorized by § 497(2) is found at 21 NYCRR §7000.10, and provides that where the deposit is not expected to "generate at least $150 in interest or such larger sum as the attorney or law firm in the exercise of his professional judgment deems may be equivalent to the cost of administering a separate account," the attorney "may choose to place these funds in a pooled IOLA account." The guideline thus reaffirms, in the context of a $150 "safe harbor," the broad IOLA deposit standard of New York Judiciary Law §497(4)(b), which states:

> The decision as to whether funds are nominal in amount or expected to be held for a short period of time rests exclusively in the sound judgment of the lawyer or law firm. Ordinarily, in determining the type of account into which to deposit particular funds held for a client, a lawyer shall take into consideration the following factors:
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> (i) the amount of interest the funds would earn during the period they are expected to be deposited;
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> (ii) the cost of establishing and administering the account, including the cost of the lawyer or law firm's services;
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> (iii) the capability of the banking institution, through subaccounting, to calculate and pay interest earned by each client's funds, net of any transaction costs, to the individual client.

Judiciary Law §497 also limits a lawyer's exposure to damages or professional misconduct charges arising out of his or her decision to deposit client funds into an IOLA account to "bad faith" claims. Subdivision (5) of the statute states: "No attorney or law firm shall be liable in damages nor held to answer for a charge of professional misconduct

because of a deposit of moneys to an IOLA account pursuant to a judgment in good faith that such moneys were qualified funds."

Most segregated interest-bearing attorney trust accounts maintained by the bank are savings accounts. When funds from the attorney trust account need to be disbursed, a transfer is made to the IOLA account from which checks are then drawn. In the metropolitan region, the interest paid by the bank on such savings accounts is currently .65 percent interest per annum. The upstate interest rate is currently .50 percent per annum.

The earnings credit factor to be employed by the bank is progressive. In the metropolitan region, if the aggregate amount of the qualifying account balances, including an IOLA account, were $5,000 or less, there would be no earnings credit. If the amount were between $5,000 and $50,000, there would be a credit of .9 percent annually. For aggregate balances above $50,000, the credit would be 1.0 percent annually. The regime would be the same upstate, except $2,500, not $5,000, would represent the breakpoint between an earnings credit of zero and an earnings credit of .9 percent.

There are a number of ethical concerns which touch upon the question presented, some of which have been brought to our attention by the inquirer. Each concern arises from the same basic dynamic – namely, the statute and regulations governing IOLA accounts give an attorney considerable discretion in determining whether to deposit client funds into an account that pays interest to the client or into an account that pays interest to the IOLA Fund, and where the anticipated interest would be less than $150, such discretion is arguably beyond all review. Whether or not the IOLA Fund benefits from the bank's proposed special program for attorneys, both the bank and the attorney would benefit whenever an attorney exercised his or her discretion in favor of a deposit into an IOLA account. The bank would benefit from paying a lower interest rate and, more importantly, the lawyer would benefit from paying lower monthly bank charges.

Notwithstanding, this arrangement would not, in our opinion, run afoul of the prohibition against charging or collecting "an illegal or excessive fee" set forth in DR 2-106(A), as the earnings credit is not a client generated "fee." Similarly, the bar of DR 9-102(A) against misappropriation of client "funds" or client "property" does not apply, as the proposed earnings credit is neither. In this respect, our prior opinions in N.Y. State 532 (1981) (a lawyer may not seek or accept interest earned on funds held in an escrow account as compensation for serving as an escrow agent), N.Y. State 582 (1987) (a lawyer may not retain interest earned on a settlement check deposited into an escrow account from the date of deposit until the date of check clearance), and N.Y. State 570 (1985) (a lawyer may not retain interest earned on an advance fee where the lawyer and client have agreed to treat the advance fee as client property), which the inquirer seeks to distinguish, are largely irrelevant.

Nor do we believe it is necessary to decide whether the determination to deposit client funds in an unsegregated IOLA account or in a segregated attorney trust account (i)

is or is not "the exercise of professional judgment" within the meaning of DR 5-101(A), thereby implicating a potential financial conflict of interest, or (ii) might "prejudice or damage the client" within the meaning of DR 7-101(A)(3).

Rather, the disposition of this inquiry is clearly governed by DR 5-107(A)(2) and EC 2-21. DR 5-107(A)(2) provides: "Except with the consent of the client after full disclosure a lawyer shall not: Accept from one other than the client anything of value related to his or her representation of or employment by the client." EC 2-21 provides: "A lawyer shall not accept compensation or anything of value incident to the lawyer's employment or services from one other than the client without the knowledge and consent of the client after full disclosure."

In N.Y. State 320 (1973), we opined that, absent disclosure and client consent, an attorney could not retain the discount received from title companies without crediting his or her client the amount of the discount. In N.Y. State 461 (1977), we opined that the acceptance of a portion of the commission obtained by a fire adjuster in connection with the loss sustained by the lawyer's client would not be unethical "provided the client, with full knowledge of the facts, has consented to the arrangement and all proceeds secured therefrom by the lawyer are credited or otherwise disbursed to the client." In N.Y. State 576 (1986) (which opinion amplified N.Y. State 351 [1974]), we opined that absent express consent to the contrary, a real estate attorney also acting as title insurance agent must reduce the client's legal fee by the amount of remuneration from such title company. In N.Y State 667 (1994), we reached the same conclusion with regard to requiring disclosure and client consent before an attorney could accept a referral fee from a mortgage broker; however, we there stated that the attorney was not required to remit the referral fee to the client if the client consented to its retention by the attorney. Each of these opinions rested upon the authority of DR 5-107(A)(2), and two of them (N.Y. State 461 and 667) cited EC 2-21.

As the trust funds to be deposited by the attorney into an attorney trust account (IOLA or non-IOLA) will only come into the attorney's hands as a consequence of the representation of a client, and as the proposed earnings credit would reduce or eliminate monthly bank charges that would otherwise be debited from the attorney's accounts, there is clearly something "of value" that is being offered to the attorney by "one other than the client" which is "related to his or her representation of or employment by the client." That the earnings credit will not influence his or her conduct with regard to the negotiation of a transaction or the prosecution or defense of a claim for which the lawyer was retained does not, in our view, take the matter outside the sweeping purview of DR 5-107(A)(2). For example, if an attorney maintains an average monthly IOLA balance in excess of $50,000, the bank will credit him or her at least $500 in reduction of bank fees for the year, not an insignificant or *de minimus* sum. Such an earnings credit may well influence the attorney's decision as to where client trust funds should be deposited, and that decision would have a direct and adverse financial impact upon the client if an IOLA account is chosen.

We do not, however, see the proposed earnings credit on IOLA accounts as presenting "so great a danger of unfairness, deception, overreaching and conflict of interest, or the appearance thereof" as to warrant a *per se* prohibition. *Compare* N.Y. State 532 (1981) ("While we interpret the Code as requiring a *per se* prohibition against retaining interest earned on escrowed funds in the circumstances stated [lawyer representing client and also serving as escrow agent in real estate transaction], we recognize a possible distinction where interest is paid on a special account in which a lawyer deposits [certain] non-escrow client funds..."). Therefore, as contemplated by DR 5-107(A), provided the client has consented to the arrangement after full disclosure, an attorney may accept an earnings credit against bank charges based upon balances held in the attorney's IOLA account.

CONCLUSION

An attorney may only accept an earnings credit against bank charges based upon balances held in the attorney's IOLA account with the consent of the client after full disclosure.

(26-03)