KBA *Bench & Bar* – Vol. 67, No.6 – Nov. 2003

Credit Cards, Firm Trust Accounts, and Thou

A friend of mine, an excellent lawyer and writer, reviews these articles for me prior to my submitting them to the *Bench & Bar* thereby saving me from many a foible. Recently, when returning an article he said, "Del, you took an intrinsically boring subject here and made it half-way interesting." Lest you think he was damning me with faint praise, that is as good as it gets for those of us who scribble on professional responsibility. This article will really challenge him because it deals with that most mundane professional responsibility of all, management of firm trust accounts.

My motivation to risk an article on this subject is a recent Maryland case disciplining a lawyer for improper management of a trust account and an Oregon bar ethics opinion concerning payment of fees by credit card. Looking further into credit card fee payments I was surprised by the number of ethical considerations that apply to these transactions. I will hedge my bet by keeping this as short as possible. First, the story of the kind of trouble to which "eyeball" management of trust accounts can lead and then an overview of ethical issues concerning payment of fees by credit card. Credit cards are featured in this article as a proxy for the increasing number of ethical questions created by evolving banking practices. Technology allowing customers to transfer funds in and out of accounts electronically, ATM transactions, the trend away from paper records to facsimile and electronic records, and the corresponding reduced ability of banks to verify double signature checks before clearing all introduce new professional responsibility issues. The ultimate point is that lawyers must keep up with these developments and apply hands-on trust account management to assure compliance with their professional responsibility to safeguard client funds and property.

The Dangers of Trust Account Management By "Eyeball"[i]

A Delaware two-lawyer firm followed the usual practice of one of the two taking responsibility for managing the firm's bookkeeping including the trust account. The firm's bookkeeper assisted the managing partner in this duty. Audits of the firm's books by the Lawyers' Fund for Client Protection revealed the following defects:

- Failure to reconcile operating and trust accounts.
- Overdrafts in the operating account.
- Checks in the amount of $27,800 written on the trust account deposited in the firm's operating account to cover shortages.
- Fabrication of a $27,800 "deposits in transit" entry in the trust account.
- Checks amounting to $26,500 written on the firm's operating account charged to legal and accounting fees, but actually used to pay personal debts of the managing partner.
- Late payment of and failure to pay taxes.

The managing partner defended himself with the classic defense that it was all the bookkeeper's fault – he claimed that he neither instructed that any of the improper actions be taken nor was he ever told of problems in meeting firm bills. The Delaware Supreme Court flatly rejected this defense finding that the managing partner had no procedures for supervising firm bookkeeping and records functions other than eyeballing them on an ad hoc basis. This sustained and systematic failure to supervise the firm's bookkeeper was a failure to exercise even a modicum of diligence and could not be passed off as simple negligence; rather it rose to the level of knowing misconduct in violation of Delaware's Professional Responsibility Rule 1.15, Safekeeping Property.[ii] The Court concluded that managing partners have an enhanced duty over that of other lawyers in the firm to assure compliance with rules governing safekeeping of client property and are held accountable to this higher standard. The Court pointed out that some practical techniques a managing partner can use to perform this responsibility effectively are conducting periodic employee performance reviews, employing outside auditors, implementing operational systems to ensure rule compliance, and requiring co-signatures on trust account checks to limit access to the account.

The upshot of the case was that the managing partner was found to have violated Rule 1.15 by commingling firm and client funds, failing to deliver property belonging to another promptly, and failing to maintain books and records. Additionally, he was found to have failed to supervise nonlawyer assistants and to have engaged in conduct involving dishonesty. The disciplinary action imposed was a suspension from practice for six months and a day.

I suggest you take a moment to reflect on your firm's trust account and bookkeeping procedures. Even if you are not responsible for supervising these functions, this does not mean you have no professional duty to be knowledgeable of their adequacy and how well they comply with Kentucky's Professional Responsibility Rule 1.15.[iii] My experience is that if you want to get a blank stare from a Kentucky lawyer, ask how the firm's trust account is managed. A typical answer is, "Not my job." This misses the principle, that while a lawyer may delegate authority for trust account management to an employee, the professional responsibility for safeguarding client property cannot be delegated. Additionally, while a managing partner may have an enhanced duty to comply with Rule 1.15 over other lawyers in a firm (at least in Delaware), every lawyer in a firm shares responsibility in some degree for proper safeguarding of client property. In my view, given the egregious nature of the Rule 1.15 violations in the Delaware case, the non-managing partner had some disciplinary action coming too – at least a letter of admonishment.

Credit Cards and Trust Accounts

The KBA Ethics Committee first approved credit card payment for legal services performed by law firms in KBA E-172 (Nov. 1977). My research revealed only one other Kentucky ethics opinion dealing with credit cards.[iv] I could find no case law or other KBA guidance on point. This is puzzling because a number of questions not an-

swered by either ethics opinion are raised when a firm accepts payment by credit card. Specifically:

- May all billing to a client be paid by credit card or only earned fees? What about retainers (unearned fees) and advance expense payments?
- In what kind of firm bank account should credit card payments be deposited when received by the bank – a business account or a trust account?
- Is it permissible to arrange for automatic charges against a client's credit card?
- How are bank credit card service charges applied? Does the full amount charged apply to the client's bill or only an amount net of bank service charges?
- If a client disputes a charge and directs the credit card issuer to "charge back" the payment against the firm's trust account, is the firm at risk of using other client funds to cover firm obligations?

What follows is a review and analysis of how some other states have answered these questions. While other state rulings are not authority for our bar, they offer helpful guidance pending KBA instruction. When in doubt, call the KBA Ethics Hotline.

May all billing to a client be paid by credit card or only earned fees? What about retainers (unearned fees) and advance expense payments?

There is no dispute that earned fees can be paid by credit card, but some states distinguish between earned fees and advance fee and expense billings in deciding what and how firms may collect by credit card. For example:

- Colorado allows credit card payment of earned fees, expenses, and advance payments, but notes that some credit card providers allow charges only for services that have been performed. Thus, as a practical matter retainers could not be charged on those cards.[v]
- Oregon allows retainers to be charged provided the bank deposits them in a firm trust account and not a business account.[vi]
- North Carolina permits credit card payment of earned and unearned fees and expenses that must be deposited in a firm's trust account.[vii]
- Missouri permits retainers, advance fees, and earned fees to be charged provided funds are deposited in a firm's trust account.[viii]

KBA E-172 approved credit card payment for "legal services performed by that firm." A strict interpretation of this language does not include retainers or advance expense payments as fees that can be charged. This unfortunately restricts the utility of accepting payment by credit card for Kentucky lawyers. The case can be made that KBA E-172 is outdated. It is a 26-year old brief opinion and is one of first impression concerning the basic question of whether credit card payments may be accepted at all by law firms in Kentucky. No attempt was made to delve into the numerous ethical issues underlying this form of fee collection. It seems a reasonable prediction that an updated KBA ethics opinion would be in line with other states and permit credit card payment of

retainers and advances on expenses. Nonetheless, some Kentucky authority to this effect is required to be sure.

In what kind of firm bank account should credit card payments be deposited when received by the bank – a business account or a trust account?

The ethical issue here is the potential for commingling client and firm funds if the bank deposits charged earned fees, retainers, and other advance payments in the same firm account. If only earned fees can be charged in Kentucky, this is a moot issue. On the assumption, however, that updated KBA ethics guidance would allow advance payment of fees and expenses to be collected by credit card the following information is offered:

- An Oregon bar ethics opinion advises that the "better practice may be to have separate … accounts for credit card retainers and earned fees. However, if a lawyer's bank insists on a single … account, it should be a trust account. …. It is not a violation … to deposit all credit card transactions into a trust account, if the portion representing earned fees is promptly transferred to the lawyer's business account."[ix]
- Maine lawyers may not comply with a bank's requirement that all credit card payments be deposited in a general business account if the credit card payments are potentially refundable to clients.[x]

While there is some variance among the states on this issue, most agree in principle with Oregon and Maine. The safest procedure, if possible, is to arrange with the bank to have two accounts for credit card payments reserving one as a trust account for unearned and unexpended client funds. In the likely event that the bank will permit only one account for deposit of credit card payments, it should be a trust account. This account then should be carefully monitored to assure that earned and expended client funds are promptly moved to the firm's operating account.

Is it permissible to arrange for automatic charges against a client's credit card?

The Missouri, South Carolina, and Nassau County (N.Y.) bars permit automatic credit card charges (*i.e.*, without the client signing the credit card slip) if the client agrees. The key consideration in all three states is clarity of client communications. It is not enough simply to include automatic credit card charges as part of the terms in a letter of engagement. A lawyer must discuss the procedure with the client and get specific approval. A receipt must be sent to the client notifying of the charge. South Carolina requires that the client be sent a bill for review before making the pre-authorized charge against the credit card. Nassau County requires a written agreement if charges are for prospective services.[xi]

By following the procedures developed in other states for automatic credit card payments, Kentucky lawyers should meet ethical requirements of client communication

and fair dealing. Nonetheless, it is an aggressive method of collecting fees that suggests a call to the KBA Ethics Hotline is in order before employing automatic credit card charge procedures.

How are bank credit card service charges applied? Does the full amount charged apply to the client's bill or only an amount net of bank service charges?

Other states have addressed this issue as follows:

- Maryland requires that lawyers accepting credit card payments add funds to cover transaction fees. It is permissible, however, to pass these costs on to clients with their agreement.[xii]
- North Carolina allows lawyers to deposit funds in a trust account to cover a bank's service charges. These charges may be passed on to clients after full disclosure.[xiii]
- Conversely, New Mexico does not permit contribution of lawyer funds to cover a bank's credit card service charges when the bank deducts charges before depositing retainers into the lawyer's account. Retainers in New Mexico, therefore, cannot be charged under these banking terms.[xiv]

Kentucky Rule 1.15 (d) provides " A lawyer may deposit funds in an account for the limited purpose of minimizing bank charges." I doubt if this provision was implemented with credit card service charges in mind, but there is no apparent reason why it cannot be fairly construed to permit lawyers to deposit funds to cover these charges as well. Accordingly, the more liberal Maryland and North Carolina approach to covering credit card service charges from firm funds should work in Kentucky. Bank service charges are typically considered law practice overhead expenses. As such they are included in the lawyer's fee and should be absorbed by the lawyer. The client should receive full credit for the amount charged – not net of service charges. This view does not preclude passing on credit card service charges to clients with full disclosure and informed consent. This, however, in my opinion is not the best business practice and may conflict with some credit card providers' conditions for service.

If a client disputes a charge and directs the credit card issuer to "charge-back" the payment against the firm's trust account, is the firm at risk of using other client funds to cover firm obligations?

If a trust account contains funds belonging to a client other than the one obtaining a charge-back, the answer to this question is "yes." When a client is able to charge-back funds against a firm's trust account without the firm's prior consent and after the client's funds have been moved to a business account, other client funds in the account are depleted.

- Maryland's answer to the problem is to require lawyers to leave funds subject to charge-back in the account until any basis for charge-back is removed (*e.g.*, client disagreement with the charge resolved, period for charge-back allowed by the credit card provider expires).[xv] Maryland also permits banking arrangements whereby a charge-back is taken from the lawyer's business account instead of the trust account.[xvi]

- A North Carolina ethics opinion advises lawyers to avoid the charge-back problem by arranging for the bank to debit a charge-back to an account other than the firm's trust account. If this is not feasible, arrangements should be made for automatic transfer of charge-back amounts from another account to the trust account. After suggesting other more complicated banking arrangements, the opinion concludes that whatever arrangements are made the end result must be that the firm immediately deposit funds covering a charge-back in a trust account if it depletes funds of other clients in the account.[xvii]

Assuming that a Kentucky firm can accept credit card payment for advance fee billings, the firm must make banking arrangements that avoid a charge-back inadvertent depletion of other client funds in a trust account. The Maryland and North Carolina approaches offer good ideas on how to proceed. If you are not confident that your arrangements comply with Rule 1.15, call the KBA Ethics Hotline for advice.

Summing Up

The most discouraging thing about the practice of law is not getting paid after providing valuable service. Unfortunately, the surest way to be sued for malpractice always has been – is – and always will be to sue a client for fees. One of the best ways to avoid the problem is to get retainers and get paid as a representation progresses. Accepting payment by credit card facilitates both of these techniques and avoids client disputes over fees. What goes with the territory, however, is the need to make careful banking arrangements that comply with the professional responsibility to protect client funds from improper disbursement and that do not commingle client funds with firm funds. Fair dealing with clients requires clear client communications, full disclosure, and informed consent when collecting fees by credit card to include the advice that there is some minor loss of confidentiality when the client charges fees. We live in a society that thrives on use of credit card payments. Offering this option for fee payment not only helps lawyers, it improves client service -- a win-win situation. With a few KBA clarifications on trust account management, Kentucky lawyers can confidently provide this service in a professionally responsible manner.

---

[i] In Re Bailey, 821 A.2d. 851 (2003); Current Reports, p. 290, Vol. 19, No. 11, 5/21/03, ABA/BNA Lawyers' Manual On Professional Conduct.

[ii] Delaware's Rule 1.15 is more expansive than Kentucky's Rule 1.15, but is essentially the same.

[iii] SCR 3.130 (1.15).

[iv] Formal Opinion KBA E-370 (September 1994) permitting use of a specialized credit card called "LAWCARD."

[v] ABA/BNA Lawyers' Manual on Professional Conduct 1101-1901, Colorado Op. 99, 5/10/97.

[vi] *Ibid*, Current Reports, Vol. 19, No. 9, p. 237 (4/23/03), Oregon Op. 2003-172, 2/03.

[vii] *Ibid*, 1101:6605, North Carolina Op. 247, 4/4/97.
[viii] *Ibid*, 1101:5263, Missouri Op. 2000202 9/00-10/00.
[ix] *Ibid*, Current Reports, Vol. 19, No. 9, p. 237 (4/23/03), Oregon Op. 2003-172, 2/03.
[x] *Ibid*, 1101:4204, Maine Op.173, 3/7/00.
[xi] *Ibid*, 1101:6255, Nassau County Op. 98-4, 3/25/98; 1101:7902, South Carolina Op. 96-07, 6/96; and 1101:5237, Missouri Op. 970040, undated.
[xii] *Ibid*, 1201:4302, Maryland Op. 2001-15, 6/19/01.
[xiii] *Ibid*, 1101:6605, North Carolina Op. 247, 4/4/97.
[xiv] *Ibid*, 1101:6001, New Mexico Op. 2000-1, undated.
[xv] *Ibid*, 1101:4305, Maryland Op. 97-14, 2/20/97.
[xvi] *Ibid*, 1201: 4306, Maryland Op.2002-23, 10/30/02.
[xvii] *Ibid*, 1101:6609, North Carolina Op. 97-9, 1/16/98.