

TRUST ACCOUNT OVERDRAFTS

By

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In 1989 the Minnesota Supreme Court amended the Minnesota Rules of Professional Conduct, providing for the implementation of the Minnesota Trust Account Overdraft Notification Program as a means for addressing the problem of lawyer theft.^{Ftn 1} Since August 1990 there have been 690 trust account overdrafts reported to the Director's Office as a result of the program. Statistics and experience from the program's first four years show that the program has provided education to many lawyers about trust account procedures, has occasionally been successful in detecting lawyer theft and also represents a cost-efficient alternative to other programs created to detect and deter lawyer theft.

HOW IT WORKS

Under Rule 1.15(k), Minnesota Rules of Professional Conduct, financial institutions report overdrafts on trust accounts to the Director's Office. These reports are typically made at the same time the account holder is notified of the account overdraft. Upon receipt of the overdraft notice, the Director notifies the lawyer or law firm of the overdraft and requests: (1) a written explanation for the overdraft; (2) a copy of the instrument(s) that caused or contributed to the overdraft; and (3) copies of trust account bank statements and client ledgers. Lawyers are informed at the outset that they need not provide this documentation if the overdraft was caused by bank error (*e.g.*, encoding errors by bank personnel or deposits into wrong accounts by bank personnel).

The information received is reviewed to determine whether the shortage was caused by theft, whether the trust account appears to be short of client funds, whether there are substantial excess funds in the account, and whether the required trust account records are being maintained.^{Ftn 2} Where the explanation and records appear adequate, the overdraft inquiry is terminated and the lawyer is notified in writing. If minor problems exist, the lawyer is either written an instruction letter pointing out the deficiencies or is given an opportunity to correct the problem and resubmit the records. In either case, the inquiry is ultimately terminated without disciplinary consequences to the lawyer or firm. In the program's first four years, 237 lawyers or law firms received this type of "on-the-spot" trust account education. In about 15 percent of the overdrafts the response or the records indicate a chronic, substantial or serious problem. In these cases, a formal disciplinary investigation is initiated and the lawyer(s) is notified of the issues under investigation. At this stage the inquiry becomes a formal disciplinary matter governed by the Minnesota Rules on Lawyers Professional Responsibility.

COMMON QUESTIONS

Q. If the bank does not dishonor or "bounce" my trust account check, and in fact pays the check even though my account was temporarily overdrawn, do I still need to respond to the overdraft notification?

A. Yes. Rule 1.15(k)(2) requires overdraft reports to the Director's Office even where checks are "presented against insufficient funds . . . but are still honored."

Q. Is an overdraft inquiry analogous to or the same as an ethics or disciplinary complaint filed against me?

A. No. Overdrafts only become disciplinary matters or investigations where the inquiry reveals problem(s) that are substantial or serious. Records of terminated overdraft inquiries are destroyed after three years. Prior to their destruction, overdraft inquiries are not disclosable and cannot be used unless there is another overdraft within the three-year period.

Q. What are the most common causes of trust account overdrafts?

A. Late deposits are the most common cause of overdrafts and typically account for nearly a quarter of the overdrafts received. If a check has been issued from the trust account, it is necessary to ensure that the instrument against which it was written is deposited prior to the bank's cut-off time on the day the trust account check was issued. Other common causes are failure to monitor and reimburse monthly service charges and check order charges.

Q. Is it permissible for financial institutions to assess a monthly service charge for lawyer trust accounts and automatically deduct the service charge amount from the trust account?

A. Yes. There is no prohibition against financial institutions assessing service charges against trust accounts. In fact, the Rules of Professional Conduct permit lawyers to deposit an amount of law firm funds into the trust account which is "reasonably sufficient" to pay service charges.[Ftn 3](#) Problems associated with the automatic assessment of service charges can also be minimized by maintaining the account at a financial institution that waives service charges on lawyer trust accounts[Ftn 4](#) or by having the financial institution charge the service charges and check order charges to a business or office account.

Q. When and why do overdraft inquiries become disciplinary investigations?

A. Overdraft inquiries are converted to disciplinary investigations when the inquiry reveals serious problems such as theft, shortages, commingling, or unauthorized withdrawals. Investigations are also initiated where the inquiry reveals a chronic failure to maintain required records and/or adhere to account balancing and reconciliation procedures. Since the program began (August 1990) only 95 disciplinary investigations have resulted from the 690 overdraft notices received. Hence, over 85 percent of the overdraft notices are resolved without resorting to the formal disciplinary process.

Q. Has the overdraft notification program detected any cases of lawyer theft?

A. Yes. In one case, the overdraft notice enabled the Director's Office to detect the lawyer's theft within several days of its occurrence, notify the affected clients before they had any reason to suspect their funds were missing, and commence proceedings that ultimately led to the lawyer's disbarment.[Ftn 5](#) In another case, the overdraft notice permitted the Director's Office to disentangle a complex trust account misappropriation case and led to the lawyer's disbarment.[Ftn 6](#) The Minnesota Supreme Court has publicly disciplined 18 lawyers as a result of overdraft notices. Two of these lawyers were disbarred and nine were suspended. Several other cases are still pending.

DOES IT WORK?

The overdraft program was never thought to be a panacea for lawyer theft. At the outset, it was contemplated that the program would occasionally detect cases of lawyer theft but that other thefts would continue to occur without program detection. One of the goals identified at the beginning of the program was the education of attorneys in trust account record keeping and procedures.^{Ftn 7} That goal appears to have been served over the last four years with over 200 attorneys and law firms being educated through the overdraft program without incurring professional discipline.

The deterrent effect of the program is and will always be difficult, if not impossible, to measure or quantify. Because the problem of lawyer theft has continued, program critics could argue that it does not deter theft. On the other hand, proponents would argue that continuing lawyer theft is hardly *prima facie* evidence that other lawyers have not been deterred.

The overdraft notification program appears to be an efficient and cost effective response to the problem of lawyer theft. It also provides the bar with much needed trust account education and in many cases without the pain of professional discipline. While many have been educated through the program, lawyers should not wait for an overdraft to occur before they examine their trust account records and procedures for compliance with the Rules of Professional Conduct and the Lawyers Professional Responsibility Board Opinions.

NOTES

¹ *The Minnesota Trust Account Overdraft Notification Procedure is authorized by Rules 1.15(j) through (n) of the Minnesota Rules of Professional Conduct.*

² *The required trust account books and records are set forth in Amended Opinion No. 9 of the Lawyers Professional Responsibility Board. Sample trust account records and transactions are illustrated in the Attorney Business and Trust Accounts brochure published in 1989 and available from the Director's Office.*

³ *See Rule 1.15(a)(1), Minnesota Rules of Professional Conduct.*

⁴ *A listing of the Minnesota financial institutions which have agreed to waive service charges and transaction fees on lawyers' trust accounts can be found at pages 28 and 29 in the December 1994 Bench & Bar.*

⁵ *In re Swerine, 513 N.W.2d 463 (Minn. 1994).*

⁶ *In re Cohen, 503 N.W.2d 771 (Minn. 1993).*

⁷ *See William J. Wernz, "Trust Account Overdraft Notice Rule," 47 Bench & Bar 9 (October 1990), at 18.*

ADDITIONAL BOARD MEMBERS

The names of three members of the Lawyers Professional Responsibility Board were inadvertently excluded from the listings published in last month's *Bench & Bar*. Here is a brief introduction to the additional members:

| KENT A. GERNANDER has been on the Board since 1992. He is a lawyer with the Winona firm of Streater, Murphy, Gernander, Forsythe & Telstad and practices primarily in the areas of civil litigation, business law, and banking. Prior to being appointed to the Board, Gernander was a member of the third District Ethics Committee and served as its chair from 1988-91.

| SALLY IRELAND ROBERTSON is a newly appointed member of the Board. She is an attorney with the Wadena firm of Kennedy & Nervig and practices primarily in the areas of family law and general civil litigation. Robertson served on the Seventh District Ethics Committee from 1987-93. She has been the director of Legal Services of Northwestern Minnesota since 1987.

| JOEL A. THEISEN is a new member of the Board. He is an attorney in private practice as a sole practitioner in Burnsville, and handles personal injury, criminal defense, family law, and real estate matters. He has served on the First District Ethics Committee and has been a member of the board of directors of the Dakota County Receiving Center since 1985.

We regret the oversight.