

OVERDRAFT NOTICE RULE

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There is an attractive simplicity about the Model Rule for Trust Account Overdraft Notification, adopted by the ABA in February. Banks agreeing to participate in the program, as they do in the Interest on Lawyers Trust Account program, would notify the Lawyers Board whenever an instrument drawn on a lawyer trust account was presented against insufficient funds. Trust account shortages could be detected and reported, perhaps at an early stage, even when the victims are unaware of the problem and have not filed an ethics complaint.

An MSBA committee, chaired by Walt Bachman of Minneapolis, has been appointed to study the Model Rule and recommend to the Board of Governors whether it should be proposed for adoption in Minnesota. A preliminary study by an MSBA committee in 1986 indicated that implementing the rule and reaping the benefits is not as simple as it sounds.

The rule's benefits would not include detecting and preventing a very large portion of misappropriations by lawyers, for several reasons. The program would not detect thefts that occur outside the trust account. When John Flanagan stole client funds, he forged endorsements on third-party checks; he also persuaded clients to invest settlement proceeds in what proved to be unsuccessful business ventures. Richard Batdorf was trustee for an elderly couple and misappropriated funds from brokerage accounts he managed for them. All of these thefts occurred outside attorney trust accounts and would have been undetected by the rule. Some other misappropriations from trust accounts occur without any NSF checks. If an attorney should have \$100,000 in a trust account, but has only \$1, the rule will not detect the shortage.

Even though the rule would not catch many misappropriations, it would catch some. The rule has been used in New Jersey for nearly four years, and annually detects about four significant misappropriations. In 1987 the rule identified an attorney who, after audit, was charged with theft of \$800,000.

Several practical concerns must be addressed in deciding whether to recommend the rule. Would costs exceed benefits? Would administrative burdens and possible liability exposures deter banks from participating? Would bank error and other circumstances beyond attorneys' control unfairly result in the opening of discipline files? There are at least tentative answers for each of these questions.

Administrative costs of the program appear to be modest. New Jersey, with nearly twice as many attorneys as Minnesota, spends less than \$11,000 annually for staff time in reviewing overdraft notices. Extrapolating from New Jersey data, one would project about 300 overdraft notices annually, for which participating banks could impose a charge. If charges were against accrued interest, they would in effect be subtractions from payments to IOLTA. Otherwise, attorneys would pay the charges. The aggregate cost of

300 notices would likely be small enough not to be a concern. Whether there would be a net cost to the Client Security Board is unclear. On one hand, some future thefts might be prevented; however, some current thefts might be detected that otherwise would have been missed. Claims against the program might actually increase, although of course if they did, client funds would have been saved or restored.

The MSBA committee plans to consult banking organizations to consider possible burdens. Possible liability exposure to attorneys for incorrect reports could be addressed by Supreme rule making reports privileged, as ethics complaints now are. Possible claims by individuals for failures to report could perhaps be addressed through Client Security Fund payment of qualified claims. Administrative burdens for banks, particularly in areas in which attorneys have few choices among banks, need to be considered.

The rule could be implemented so as to address attorney concerns with consequences that might flow from banks incorrectly reporting overdrafts. In New Jersey, experience has shown that about 95 percent of all overdraft notices stem from problems that do not warrant disciplinary investigation. No discipline investigation file would be opened unless review of documents associated with the notice indicated a reasonable basis for believing misconduct may have occurred.

In considering whether the benefit of detecting a handful of trust account shortages outweighs the costs and burdens of the program, attention should also be paid to other benefits. Education would be chief among these benefits. Sometimes a trust account is genuinely overdrawn, but through an attorney's inexperience. For example, an attorney may make disbursements out of settlement proceeds, only to discover that the settlement deposit is later dishonored. If the disbursements cannot be recovered, shortages for other clients who had funds in the account can result. Early detection of this kind of problem, coupled with instruction on proper books and records and trust account procedures, may prevent unwitting shortages.

The trust account overdraft notice rule should also be considered in the wider context of other preventive measures. Again one of these is education. The Office of Lawyers Professional Responsibility will soon be distributing to all attorneys a brochure describing and illustrating proper trust account books, records, and procedures. The Client Security Board will be reviewing other possible preventive measures. One of these is the random audit program used in several other states. The main drawback of this program is the cost of employing enough auditors to make the program effective. It would also miss the defalcations occurring outside the trust account. The Board of Law Examiners is also more vigorously and frequently conducting character fitness reviews before applicants are admitted to the bar. Deterrence from misappropriation is also an important preventive measure — disbarment or lengthy suspension has been the presumptive discipline in Minnesota for sizeable misappropriation. Although criminal prosecution is distinct from the professional responsibility system, the effective prosecution of several attorneys in the last few years may help to deter future misconduct. A combination of disciplinary, preventive, deterrent, and educational measures may reduce misappropriations.

No combination of preventive measures can prevent all, or perhaps even most, misappropriations of client funds. The nature of the professional relationship is that of an intimate trust, so that any outside scrutiny and regulation will necessarily be limited. The wily and truly dishonest thief will be impervious to education and will elude some or all detection programs.

Several states have adopted versions of the rule which are ineffective. For example, some allow a "cure" before notice is given of the overdraft. A couple of other states have adopted or are about to adopt a

rule substantially like the Model Rule. Only New Jersey has had the rule in effect for a long enough period to learn from experience.

The committee is soliciting comment of all interested lawyers in discerning the benefits and burdens of the Model Rule. By next spring the committee expects to make its recommendations regarding the rule. Comments may be addressed to Walt Bachman or to the associate executive director of the MSBA, Mary Jo Ruff.