

**Rule 1.15 [4-100] Safekeeping of Funds and Property of Clients and Other Persons
(Commission's Proposed Rule Adopted on June 2 – 3, 2016 – Clean Version)**

- (a) All funds received or held by a lawyer or law firm* for the benefit of a client, or other person* to whom the lawyer owes a contractual, statutory, or other legal duty, including advances for fees, costs and expenses, shall be deposited in one or more identifiable bank accounts labelled "Trust Account" or words of similar import, maintained in the State of California, or, with written* consent of the client, in any other jurisdiction where there is a substantial* relationship between the client or the client's business and the other jurisdiction.
- (b) Notwithstanding paragraph (a), a flat fee paid in advance for legal services may be deposited in a lawyer's or law firm's operating account, provided:
 - (1) The lawyer or law firm* discloses to the client in writing* (i) that the client has a right under paragraph (a) to require that the flat fee be deposited in an identified trust account until the fee is earned, and (ii) that the client is entitled to a refund of any amount of the fee that has not been earned in the event the representation is terminated or the services for which the fee has been paid are not completed, and
 - (2) The client's agreement to deposit the flat fee in the lawyer's operating account and the disclosures required by paragraph (b)(1) are set forth in a writing* signed by the client.
- (c) Funds belonging to the lawyer or the law firm* shall not be deposited or otherwise commingled with funds held in a trust account except:
 - (1) funds reasonably* sufficient to pay bank charges.
 - (2) funds belonging in part to a client or other person* and in part presently or potentially to the lawyer or the law firm,* in which case the portion belonging to the lawyer or law firm* must be withdrawn at the earliest reasonable* time after the lawyer or law firm's interest in that portion becomes fixed. However, if a client or other person* disputes the lawyer or law firm's right to receive a portion of trust funds, the disputed portion shall not be withdrawn until the dispute is finally resolved.
- (d) A lawyer shall:
 - (1) promptly notify a client or other person* of the receipt of funds, securities, or other property in which the lawyer knows* or reasonably should know* the client or other person* has an interest;
 - (2) identify and label securities and properties of a client or other person* promptly upon receipt and place them in a safe deposit box or other place of safekeeping as soon as practicable;

- (3) maintain complete records of all funds, securities, and other property of a client or other person* coming into the possession of the lawyer or law firm;*
 - (4) promptly account in writing* to the client or other person* for whom the lawyer holds funds or property;
 - (5) preserve records of all funds and property held by a lawyer or law firm* under this Rule for a period of no less than five years after final appropriate distribution of such funds or property;
 - (6) comply with any order for an audit of such records issued pursuant to the Rules of Procedure of the State Bar.
 - (7) promptly distribute, as requested by the client or other person,* any undisputed funds or property in the possession of the lawyer or law firm* that the client or other person* is entitled to receive.
- (e) The Board of Trustees of the State Bar shall have the authority to formulate and adopt standards as to what "records" shall be maintained by lawyers and law firms* in accordance with subparagraph(d)(3). The standards formulated and adopted by the Board, as from time to time amended, shall be effective and binding on all lawyers.

Standards:

Pursuant to this Rule, the Board of Trustees of the State Bar adopted the following standards, effective _____, as to what "records" shall be maintained by lawyers and law firms* in accordance with subparagraph (d)(3).

- (1) A lawyer shall, from the date of receipt of funds of the client or other person* through the period ending five years from the date of appropriate disbursement of such funds, maintain:
 - (a) a written* ledger for each client or other person* on whose behalf funds are held that sets forth:
 - (i) the name of such client or other person,
 - (ii) the date, amount and source of all funds received on behalf of such client or other person,
 - (iii) the date, amount, payee and purpose of each disbursement made on behalf of such client or other person,* and
 - (iv) the current balance for such client or other person;
 - (b) a written* journal for each bank account that sets forth:
 - (i) the name of such account,

- (ii) the date, amount and client affected by each debit and credit, and
 - (iii) the current balance in such account;
 - (c) all bank statements and cancelled checks for each bank account; and
 - (d) each monthly reconciliation (balancing) of (a), (b), and (c).
- (2) A lawyer shall, from the date of receipt of all securities and other properties held for the benefit of client or other person* through the period ending five years from the date of appropriate disbursement of such securities and other properties, maintain a written* journal that specifies:
- (a) each item of security and property held;
 - (b) the person* on whose behalf the security or property is held;
 - (c) the date of receipt of the security or property;
 - (d) the date of distribution of the security or property; and
 - (e) person* to whom the security or property was distributed.

Comment

[1] Whether a lawyer owes a contractual, statutory or other legal duty under paragraph (a) to hold funds on behalf of a person* other than a client in situations where client funds are subject to a third-party lien will depend on the relationship between the lawyer and the third-party, whether the lawyer has assumed a contractual obligation to the third person* and whether the lawyer has an independent obligation to honor the lien under a statute or other law. In certain circumstances, a lawyer may be civilly liable when the lawyer has notice of a lien and disburses funds in contravention of the lien. See *Kaiser Foundation Health Plan, Inc. v. Aguiluz* (1996) 47 Cal.App.4th 302 [54 Cal.Rptr.2d 665]. However, civil liability by itself does not establish a violation of this Rule. Compare *Johnstone v. State Bar of California* (1966) 64 Cal.2d 153, 155-156 [49 Cal.Rptr. 97] (“When an attorney assumes a fiduciary relationship and violates his duty in a manner that would justify disciplinary action if the relationship had been that of attorney and client, he may properly be disciplined for his misconduct.”) and *Crooks v. State Bar* (1970) 3 Cal.3d 346, 358 [90 Cal.Rptr. 600] (lawyer who agrees to act as escrow or stakeholder for a client and a third-party owes a duty to the nonclient with regard to held funds).

[2] As used in this Rule, “advances for fees” means a payment intended by the client as an advance payment for some or all of the services that the lawyer is expected to perform on the client's behalf. With respect to the difference between a true retainer and a flat fee, which is one type of advance fee, see Rule 1.5(d) and (e). Subject to Rule 1.5, a lawyer or law firm* may enter into an agreement that defines when or how an advance fee is earned and may be withdrawn from the client trust account.

[3] Absent written* disclosure and the client's agreement in a writing* signed by the client as provided in paragraph (b), a lawyer must deposit a flat fee paid in advance of legal services in the lawyer's trust account. Paragraph (b) does not apply to advance payment for costs and expenses. Paragraph (b) does not alter the lawyer's obligations under paragraph (d) or the lawyer's burden to establish that the fee has been earned.

PROPOSED RULE OF PROFESSIONAL CONDUCT 1.15
(Current Rule 4-100)
Safekeeping Funds and Property of Clients and Other Persons

EXECUTIVE SUMMARY

The Commission for the Revision of the Rules of Professional Conduct (“Commission”) has evaluated current rule 4-100 (Preserving Identity of Funds and Property of a Client) in accordance with the Commission Charter, with a focus on the function of the rule as a disciplinary standard, and with the understanding that the rule comments should be included only when necessary to explain a rule and not for providing aspirational guidance. In addition, the Commission considered American Bar Association (“ABA”) counterpart, Model Rule 1.15 (Safekeeping Property). The Commission also reviewed relevant California statutes, rules, and case law relating to the issues addressed by the proposed rules. The result of the Commission’s evaluation is proposed rule 1.15 (Safekeeping Property). This proposed rule has been adopted by the Commission for submission to the Board of Trustees for public comment authorization. A final recommended rule will follow the public comment process.

Proposed rule 1.15 amends current rule 4-100. In substance, it continues the various requirements of the current rule concerning the holding of client funds and property, including the duty to properly account for such funds and property. Proposed rule 1.15 also continues the existing authorization for the Board to adopt recordkeeping standards (proposed paragraph (e)).

The two main issues considered by the Commission in studying this rule were whether to require that: (i) fees paid in advance, including a flat fee, be held in trust until the fees have been earned; and (ii) the duties owed to a client be extended to other persons, such a statutory lienholder with a claim against funds held by the lawyer. The Commission is recommending that both changes be implemented in the proposed rule.

Fees Paid in Advance. Proposed paragraph (a) requires that fees paid in advance be held in trust similar to the current rule’s requirement on advances for costs and expenses.¹ The Commission also recommends a new paragraph (b) to address the specific issue of a lawyer’s handling of *flat* fees paid in advance, including a protocol that would permit a lawyer to hold such fees in a firm’s operating account rather than a trust account.

Proposed paragraph (b) provides:

- (b) Notwithstanding paragraph (a), a flat fee paid in advance for legal services may be deposited in a lawyer’s or law firm’s operating account, provided:
 - (1) The lawyer or law firm discloses to the client in writing (i) that the client has a right under paragraph (a) to require that the flat fee be deposited in an identified trust account until the fee is earned, and (ii) that the client is entitled to a refund of any amount of the fee that has not been earned in the event the representation is terminated or the services for which the fee has been paid are not completed, and

¹ Proposed paragraph (a), in relevant part, has been revised as follows: “All funds received. . . , including advances for **fees**, costs and expenses, shall be deposited in one or more identifiable [trust accounts].”

- (2) The client's agreement to deposit the flat fee in the lawyer's operating account and the disclosures required by paragraph (b)(1) are set forth in a writing signed by the client.

Paragraph (b) is intended to balance competing interests: (i) the public protection afforded by a rule intended to assure that unearned fees are available for a refund to a client; and, (ii) the freedom of a lawyer and client by agreement to set the terms of a fee arrangement.

Reports of insufficient funds in a client trust account are a significant concern in attorney discipline.² At the same time, comments by stakeholders to the first Commission have asserted that a requirement to hold certain fees in a client trust account would be contrary to a client's best interest and would impair a lawyer's ability to focus on a client's representation. In particular, comments from criminal defense lawyers and lawyers who represent clients against the Internal Revenue Service or Franchise Tax Board have expressed concerns that holding advance fees in a trust account creates unnecessary risks of the loss of those funds through government seizure or forfeiture.³

Paragraph (b) seeks to accommodate both of these interests by permitting a flat fee paid in advance to be held in a law firm operating account so long as the lawyer provides a mandatory disclosure to the client and obtains the client's agreement in a writing signed by the client. This permissive option is intended to be limited to a *flat* fee paid in advance rather than all fees paid in advance, in part, because commenters have expressed the view that this particular fee arrangement represents a situation where the fees are earned upon receipt and holding such fees in a client trust account would be inconsistent with the basic fiduciary obligation to segregate funds that belong to a lawyer or law firm. Similarly, paragraph (b) would not apply to a true retainer fee as defined in proposed rule 1.5(d) and (e) [current rule 3-700(D)(2)].

Although proposed paragraph (b) permits a flat fee to be held in a law firm operating account, it does not diminish a lawyer's obligation to account for the funds or to refund any amount owing to a client due to a subsequent unexpected failure of consideration. For example, a situation could arise where a lawyer is unable to complete the contemplated legal services due to accident or illness and a refund would be required in this instance despite the fact that the funds might not have been held in a trust account.

The approach proposed in paragraph (b) builds on the State Bar's prior attempts to implement rule changes in the area of advance fees. This includes a 1992 rule filing that would have

² The [2015 State Bar Annual Discipline Report](#) indicates that: "The most common action reported by others, accounting for approximately eighty percent of all reports each year, was actions falling under [Bus. & Prof. Code] section 6091.1, which requires financial institutions to report overdrafts from attorney trust accounts." (2015 State Bar Annual Discipline Report at p. 19.)

³ For example, in 2010 the first Commission received a comment from attorney Paul L. Gabbert stating:

In criminal securities litigation involving federal prosecutors and the Securities and Exchange Commission ("SEC") payment of attorney's fees and the relationship of that payment to restraining orders and preliminary injunctions can not only distract the attorney from the case she was hired to defend, it can eclipse the underlying case and result in the attorney having to defend herself in contempt proceedings based on how her fee was paid. Even when the attorney prevails in the litigation, this can result in the functional equivalent of a fee forfeiture because the cost of successfully defending the civil contempt action can greatly reduce or eradicate the fee paid to defend the client in the underlying criminal action. . . .¶ True retainers and other fixed fees are the only way for practitioners to avoid these pitfalls.

amended rule 4-100 to provide that: “Unless a written fee agreement expressly provides that a fee paid in advance is earned when paid or is a true retainer (as set forth in rule 3-700(D)(2)), all advance fees received shall be deposited in one or more [client trust accounts].” (See October 1992 State Bar rule filing, Supreme Court case no. S029270.) It also includes an effort in 1997 by the Committee on Professional Responsibility and Conduct (“COPRAC”) that would have required advance fees to be held in trust unless the lawyer obtained a client’s informed written authorization to deposit those funds in another account. These attempts created issues that precipitated questions and substantial adverse public comment. With respect to the 1992 proposal, the Supreme Court raised a question about an ambiguity as to the use of the term “earned when paid” and the duty to refund “unearned” fees. The 1997 proposal also engendered claims of ambiguity. The proposal was criticized, in part, for creating a new concept of “informed written authorization” that was perceived as more than written disclosure but less than informed consent. The Commission believes that proposed paragraph (b) is responsive to the concerns raised with respect to these prior, unsuccessful attempts at reform.

The Commission also considered whether proposed paragraph (b) would work together with the Commission’s non-refundable and flat fee provisions in proposed rule 1.5 (“Fees for Legal Services”) (see the executive summary of proposed rule 1.5) that include a definition of a “flat fee,” and concluded that it would. In relevant part, proposed rule 1.5 states that:

(d) A lawyer may make an agreement for, charge, or collect a fee that is denominated as “earned on receipt” or “non-refundable,” or in similar terms, only if the fee is a true retainer and the client agrees in writing after disclosure that the client will not be entitled to a refund of all or part of the fee charged. A true retainer is a fee that a client pays to a lawyer to ensure the lawyer’s availability to the client during a specified period or on a specified matter, but not to any extent as compensation for legal services performed or to be performed.

(e) A lawyer may make an agreement for, charge, or collect a flat fee for specified legal services as long as the lawyer performs the agreed upon services. A flat fee is a fee which constitutes complete payment for legal fees to be performed in the future for a fixed sum regardless of the amount of work ultimately involved and which may be paid in whole or in part in advance of the lawyer providing those services.

Taken together, the proposed rules 1.5 and 1.15 would implement enhanced public protection by: (1) prohibiting a “nonrefundable fee” except for a true retainer; (2) generally requiring that advanced fees be held in trust; and (3) providing a limited permissive option for flat fee arrangements.

Extending the Rule to Cover Other Persons. The Commission recommends adding the concept that under certain circumstances a lawyer owes duties to protect funds and property of a third person. This change is comparable to the standard in Model Rule 1.15 and to the rules adopted in some jurisdictions. Most significantly, California case law has held that a lawyer owes such duties to third persons. The Commission is concerned that current rule 4-100 is deficient to the extent that it hides the ball on the issue of funds and property entrusted by non-clients. By clarifying the rule, lawyer compliance would be facilitated. To explain this new addition to the rule, the Commission drafted proposed Comment [5] that states:

[5] Whether a lawyer owes a contractual, statutory or other legal duty under paragraph (a) to hold funds on behalf of a person other than a client in situations where client funds are subject to a third-party lien will depend on the relationship between the lawyer and the third party, whether the lawyer has assumed a

contractual obligation to the third person and whether the lawyer has an independent obligation to honor the lien under a statute or other law. In certain circumstances, a lawyer may be civilly liable when the lawyer has notice of a lien and disburses funds in contravention of the lien. See *Kaiser Foundation Health Plan, Inc. v. Aguiluz* (1996) 47 Cal.App.4th 302. However, civil liability by itself does not establish a violation of this Rule. Compare *Johnstone v. State Bar of California* (1966) 64 Cal.2d 153, 155-156 (“When an attorney assumes a fiduciary relationship and violates his duty in a manner that would justify disciplinary action if the relationship had been that of attorney and client, he may properly be disciplined for his misconduct.”) and *Crooks v. State Bar* (1970) 3 Cal.3d 346, 358 (lawyer who agrees to act as escrow or stakeholder for a client and a third party owes a duty to the nonclient with regard to held funds).

This explanatory comment is important because it alerts lawyers to the fact that case law research may be needed to ascertain the nature and extent of a duty owed to a third person.⁴ Other proposed comments explain what is meant by the term “advances for fees” (see proposed Comment [2]) and caution that paragraph (b)’s protocol for holding a flat fee in a firm operating account does not diminish a lawyer’s duty to account for the fee or the lawyer’s burden to establish that the fee has been earned.

⁴ In some circumstances, the duty imposed by the proposed rule may be a requirement to communicate and inform a third person concerning that person’s claim to client trust funds (see *In the Matter of Nunez* (Review Dept. 1992) 2 Cal State Bar Ct. Rptr. 196 [lawyer believed that client’s bankruptcy would nullify a lien and failed to communicate with the lienholder concerning the lien claim), while in other situations a lawyer might be required to withhold disbursement of funds to the lawyer’s client to protect the rights of a third person (see *In the Matter of Respondent P* (Review Dept. 1993) 2 Cal. State Bar Ct. Rptr. 622 [lawyer’s failure to honor a statutory Medi-Cal lien]).

Rule ~~4-100 Preserving Identity of~~ 1.15 Safekeeping Funds and Property of ~~a-Client~~ Clients and Other Persons*

(Redline Comparison of the Proposed Rule to Current California Rule)

- (a) All funds received or held by a lawyer or law firm* for the benefit of ~~clients by a member or law firm~~ a client, or other person* to whom the lawyer owes a contractual, statutory, or other legal duty, including advances for fees, costs and expenses, shall be deposited in one or more identifiable bank accounts ~~labeled~~ labelled "Trust ~~Account,~~ Account," ~~"Client's Funds~~ Account" or words of similar import, maintained in the State of California, or, with written* consent of the client, in any other jurisdiction where there is a substantial* relationship between the client or the client's business and the other jurisdiction. ~~No funds~~
- (b) Notwithstanding paragraph (a), a flat fee paid in advance for legal services may be deposited in a lawyer's or law firm's operating account, provided:
- (1) The lawyer or law firm* discloses to the client in writing* (i) that the client has a right under paragraph (a) to require that the flat fee be deposited in an identified trust account until the fee is earned, and (ii) that the client is entitled to a refund of any amount of the fee that has not been earned in the event the representation is terminated or the services for which the fee has been paid are not completed, and
 - (2) The client's agreement to deposit the flat fee in the lawyer's operating account and the disclosures required by paragraph (b)(1) are set forth in a writing* signed by the client.
- (A)(c) Funds belonging to the ~~member~~ lawyer or the law firm shall not be deposited ~~therein~~ or otherwise commingled therewith with funds held in a trust account except as follows:
- (1) ~~Funds~~ funds reasonably* sufficient to pay bank charges.
 - (2) ~~In the case of~~ funds belonging in part to a client or other person* and in part presently or potentially to the ~~member~~ lawyer or the law firm,* in which case the portion belonging to the ~~member~~ lawyer or law firm* must be withdrawn at the earliest reasonable* time after the ~~member's~~ lawyer or law firm's interest in that portion becomes fixed. However, ~~when the right of the member~~ if a client or other person* disputes the lawyer or law firm's right to receive a portion of trust funds ~~is disputed by the client,~~ the disputed portion shall not be withdrawn until the dispute is finally resolved.
- (B)(d) A ~~member~~ lawyer shall:
- (1) Promptly ~~promptly~~ notify a client or other person of the receipt of ~~the client's~~ funds, securities, or other properties. property in which the lawyer

knows or reasonably should know the client or other person has an interest;

- (2) ~~Identify~~identify and label securities and properties of a client or other person* promptly upon receipt and place them in a safe deposit box or other place of safekeeping as soon as practicable~~;~~;
- (3) ~~Maintain~~maintain complete records of all funds, securities, and other ~~properties~~property of a client or other person* coming into the possession of the ~~member~~lawyer or law firm* ~~and render appropriate accounts to the client regarding them;~~
- (4) promptly account in writing* to the client or other person* for whom the lawyer holds funds or property;
- (5) preserve ~~such~~-records of all funds and property held by a lawyer or law firm* under this Rule for a period of no less than five years after final appropriate distribution of such funds or ~~properties~~property; ~~and~~
- ~~(3)~~(6) comply with any order for an audit of such records issued pursuant to the Rules of Procedure of the State Bar.
- (7) promptly distribute, as requested by the client or other person,* any undisputed funds or property in the possession of the lawyer or law firm* that the client or other person* is entitled to receive.
- ~~(4)~~—~~Promptly pay or deliver, as requested by the client, any funds, securities, or other properties in the possession of the member which the client is entitled to receive.~~
- (C)(e) The Board of ~~Governors~~Trustees of the State Bar shall have the authority to formulate and adopt standards as to what “records” shall be maintained by ~~members~~lawyers and law firms* in accordance with subparagraph(Bd)(3). The standards formulated and adopted by the Board, as from time to time amended, shall be effective and binding on all ~~members~~lawyers.

Standards:

Pursuant to ~~rule 4-100(C)~~this Rule, the Board of ~~Governors~~Trustees of the State Bar adopted the following standards, effective ~~January 1, [1993]~~_____, as to what “records” shall be maintained by ~~members~~lawyers and law firms* in accordance with subparagraph (Bd)(3).

- (1) A ~~member~~lawyer shall, from the date of receipt of ~~client~~-funds of the client or other person* through the period ending five years from the date of appropriate disbursement of such funds, maintain:
 - (a) a written* ledger for each client or other person* on whose behalf funds are held that sets forth:

- (i) the name of such client [or other person](#),
 - (ii) the date, amount and source of all funds received on behalf of such client [or other person](#),
 - (iii) the date, amount, payee and purpose of each disbursement made on behalf of such client [or other person](#),* and
 - (iv) the current balance for such client [or other person](#);
- (b) a written* journal for each bank account that sets forth:
- (i) the name of such account,
 - (ii) the date, amount and client affected by each debit and credit, and
 - (iii) the current balance in such account;
- (c) all bank statements and ~~canceled~~[cancelled](#) checks for each bank account; and
- (d) each monthly reconciliation (balancing) of (a), (b), and (c).
- (2) A ~~member~~[lawyer](#) shall, from the date of receipt of all securities and other properties held for the benefit of client [or other person](#)* through the period ending five years from the date of appropriate disbursement of such securities and other properties, maintain a written* journal that specifies:
- (a) each item of security and property held;
 - (b) the person* on whose behalf the security or property is held;
 - (c) the date of receipt of the security or property;
 - (d) the date of distribution of the security or property; and
 - (e) person* to whom the security or property was distributed.

Comment

[\[1\] Whether a lawyer owes a contractual, statutory or other legal duty under paragraph \(a\) to hold funds on behalf of a person* other than a client in situations where client funds are subject to a third-party lien will depend on the relationship between the lawyer and the third-party, whether the lawyer has assumed a contractual obligation to the third person* and whether the lawyer has an independent obligation to honor the lien under a statute or other law. In certain circumstances, a lawyer may be civilly liable when the lawyer has notice of a lien and disburses funds in contravention of the lien. See *Kaiser Foundation Health Plan, Inc. v. Aguiluz* \(1996\) 47 Cal.App.4th 302 \[54 Cal.Rptr.2d 665\]. However, civil liability by itself does not establish a violation of this Rule. Compare *Johnstone v. State Bar of California* \(1966\) 64 Cal.2d 153, 155-156 \[49 Cal.Rptr. 97\]](#)

(“When an attorney assumes a fiduciary relationship and violates his duty in a manner that would justify disciplinary action if the relationship had been that of attorney and client, he may properly be disciplined for his misconduct.”) and *Crooks v. State Bar* (1970) 3 Cal.3d 346, 358 [90 Cal.Rptr. 600] (lawyer who agrees to act as escrow or stakeholder for a client and a third-party owes a duty to the nonclient with regard to held funds).

[2] As used in this Rule, “advances for fees” means a payment intended by the client as an advance payment for some or all of the services that the lawyer is expected to perform on the client's behalf. With respect to the difference between a true retainer and a flat fee, which is one type of advance fee, see Rule 1.5(d) and (e). Subject to Rule 1.5, a lawyer or law firm* may enter into an agreement that defines when or how an advance fee is earned and may be withdrawn from the client trust account.

[3] Absent written* disclosure and the client's agreement in a writing* signed by the client as provided in paragraph (b), a lawyer must deposit a flat fee paid in advance of legal services in the lawyer's trust account. Paragraph (b) does not apply to advance payment for costs and expenses. Paragraph (b) does not alter the lawyer's obligations under paragraph (d) or the lawyer's burden to establish that the fee has been earned.

COMMISSION PROVISIONAL REPORT AND RECOMMENDATION: RULE 1.15 [4-100]

Commission Drafting Team Information

Lead Drafter: Mark Tuft

Co-Drafters: James Ham, Raul Martinez

Meeting Dates at which the Rule was Discussed: May 6-7, 2016 and June 2-3, 2016

Action Summary Approval Date:

I. CURRENT CALIFORNIA RULE

Rule 4-100 Preserving Identity of Funds and Property of a Client

- (A) All funds received or held for the benefit of clients by a member or law firm, including advances for costs and expenses, shall be deposited in one or more identifiable bank accounts labelled "Trust Account," "Client's Funds Account" or words of similar import, maintained in the State of California, or, with written consent of the client, in any other jurisdiction where there is a substantial relationship between the client or the client's business and the other jurisdiction. No funds belonging to the member or the law firm shall be deposited therein or otherwise commingled therewith except as follows:
- (1) Funds reasonably sufficient to pay bank charges.
 - (2) In the case of funds belonging in part to a client and in part presently or potentially to the member or the law firm, the portion belonging to the member or law firm must be withdrawn at the earliest reasonable time after the member's interest in that portion becomes fixed. However, when the right of the member or law firm to receive a portion of trust funds is disputed by the client, the disputed portion shall not be withdrawn until the dispute is finally resolved.
- (B) A member shall:
- (1) Promptly notify a client of the receipt of the client's funds, securities, or other properties.
 - (2) Identify and label securities and properties of a client promptly upon receipt and place them in a safe deposit box or other place of safekeeping as soon as practicable.
 - (3) Maintain complete records of all funds, securities, and other properties of a client coming into the possession of the member or law firm and render appropriate accounts to the client regarding them; preserve such records for a period of no less than five years after final appropriate distribution of such funds or properties; and comply with any order for an audit of such records issued pursuant to the Rules of Procedure of the State Bar.
 - (4) Promptly pay or deliver, as requested by the client, any funds, securities, or other properties in the possession of the member which the client is entitled to receive.

COMMISSION PROVISIONAL REPORT AND RECOMMENDATION: RULE 1.15 [4-100]

- (C) The Board of Governors of the State Bar shall have the authority to formulate and adopt standards as to what "records" shall be maintained by members and law firms in accordance with subparagraph(B)(3). The standards formulated and adopted by the Board, as from time to time amended, shall be effective and binding on all members.

Standards:

Pursuant to rule 4-100(C) the Board of Governors of the State Bar adopted the following standards, effective January 1, 1993, as to what "records" shall be maintained by members and law firms in accordance with subparagraph(B)(3).

- (1) A member shall, from the date of receipt of client funds through the period ending five years from the date of appropriate disbursement of such funds, maintain:
- (a) a written ledger for each client on whose behalf funds are held that sets forth:
 - (i) the name of such client,
 - (ii) the date, amount and source of all funds received on behalf of such client,
 - (iii) the date, amount, payee and purpose of each disbursement made on behalf of such client, and
 - (iv) the current balance for such client;
 - (b) a written journal for each bank account that sets forth:
 - (i) the name of such account,
 - (ii) the date, amount and client affected by each debit and credit, and
 - (iii) the current balance in such account;
 - (c) all bank statements and cancelled checks for each bank account; and
 - (d) each monthly reconciliation(balancing) of(a),(b), and(c).
- (2) A member shall, from the date of receipt of all securities and other properties held for the benefit of client through the period ending five years from the date of appropriate disbursement of such securities and other properties, maintain a written journal that specifies:
- (a) each item of security and property held;
 - (b) the person on whose behalf the security or property is held;
 - (c) the date of receipt of the security or property;

COMMISSION PROVISIONAL REPORT AND RECOMMENDATION: RULE 1.15 [4-100]

- (d) the date of distribution of the security or property; and
- (e) person to whom the security or property was distributed.

II. COMMISSION'S RECOMMENDATION AND VOTE

The Commission voted to recommend a proposed rule as set forth below in Section III.

At the Commission's May 6-7, 2016 meeting, all members present voted to recommend adoption the black letter text and Standards of the proposed rule, subject to further revisions to address the issue of placement of advance fees in the trust account and possible comments.

At the Commission's June 2-3, 2016 meeting, a majority of members present voted to recommend adoption of paragraphs (a) and (b) of the proposed rule, revised to address the advance fee placement issue, with Ms. Langford voting no.

At the Commission's June 2-3, 2016 meeting, a majority of members present voted to recommend adoption of Comment [1] of the proposed rule, with Mr. Tuft voting no.

At the Commission's June 3, 2016 meeting, all members present voted to recommend adoption of Comments [2] and [3] of the proposed rule.

III. COMMISSION'S PROPOSED RULE 1.15 (CLEAN)

Rule 1.15 Safekeeping Funds and Property of Clients and Other Persons

- (a) All funds received or held by a lawyer or law firm* for the benefit of a client, or other person* to whom the lawyer owes a contractual, statutory, or other legal duty, including advances for fees, costs and expenses, shall be deposited in one or more identifiable bank accounts labelled "Trust Account" or words of similar import, maintained in the State of California, or, with written* consent of the client, in any other jurisdiction where there is a substantial* relationship between the client or the client's business and the other jurisdiction.
- (b) Notwithstanding paragraph (a), a flat fee paid in advance for legal services may be deposited in a lawyer's or law firm's operating account, provided:
 - (1) The lawyer or law firm* discloses to the client in writing* (i) that the client has a right under paragraph (a) to require that the flat fee be deposited in an identified trust account until the fee is earned, and (ii) that the client is entitled to a refund of any amount of the fee that has not been earned in the event the representation is terminated or the services for which the fee has been paid are not completed, and
 - (2) The client's agreement to deposit the flat fee in the lawyer's operating account and the disclosures required by paragraph (b)(1) are set forth in a writing* signed

**COMMISSION PROVISIONAL REPORT AND RECOMMENDATION:
RULE 1.15 [4-100]**

by the client.

- (c) Funds belonging to the lawyer or the law firm* shall not be deposited or otherwise commingled with funds held in a trust account except:
- (1) funds reasonably* sufficient to pay bank charges.
 - (2) funds belonging in part to a client or other person* and in part presently or potentially to the lawyer or the law firm,* in which case the portion belonging to the lawyer or law firm* must be withdrawn at the earliest reasonable* time after the lawyer or law firm's interest in that portion becomes fixed. However, if a client or other person* disputes the lawyer or law firm's right to receive a portion of trust funds, the disputed portion shall not be withdrawn until the dispute is finally resolved.
- (d) A lawyer shall:
- (1) promptly notify a client or other person* of the receipt of funds, securities, or other property in which the lawyer knows* or reasonably should know* the client or other person* has an interest;
 - (2) identify and label securities and properties of a client or other person* promptly upon receipt and place them in a safe deposit box or other place of safekeeping as soon as practicable;
 - (3) maintain complete records of all funds, securities, and other property of a client or other person* coming into the possession of the lawyer or law firm*;
 - (4) promptly account in writing* to the client or other person* for whom the lawyer holds funds or property;
 - (5) preserve records of all funds and property held by a lawyer or law firm* under this Rule for a period of no less than five years after final appropriate distribution of such funds or property;
 - (6) comply with any order for an audit of such records issued pursuant to the Rules of Procedure of the State Bar.
 - (7) promptly distribute, as requested by the client or other person,* any undisputed funds or property in the possession of the lawyer or law firm* that the client or other person* is entitled to receive.
- (e) The Board of Trustees of the State Bar shall have the authority to formulate and adopt standards as to what "records" shall be maintained by lawyers and law firms* in accordance with subparagraph(d)(3). The standards formulated and adopted by the Board, as from time to time amended, shall be effective and binding on all lawyers.

COMMISSION PROVISIONAL REPORT AND RECOMMENDATION: RULE 1.15 [4-100]

Standards:

Pursuant to this Rule, the Board of Trustees of the State Bar adopted the following standards, effective _____, as to what "records" shall be maintained by lawyers and law firms* in accordance with subparagraph (d)(3).

- (1) A lawyer shall, from the date of receipt of funds of the client or other person* through the period ending five years from the date of appropriate disbursement of such funds, maintain:
 - (a) a written* ledger for each client or other person* on whose behalf funds are held that sets forth:
 - (i) the name of such client or other person,
 - (ii) the date, amount and source of all funds received on behalf of such client or other person,
 - (iii) the date, amount, payee and purpose of each disbursement made on behalf of such client or other person,* and
 - (iv) the current balance for such client or other person;
 - (b) a written* journal for each bank account that sets forth:
 - (i) the name of such account,
 - (ii) the date, amount and client affected by each debit and credit, and
 - (iii) the current balance in such account;
 - (c) all bank statements and cancelled checks for each bank account; and
 - (d) each monthly reconciliation (balancing) of (a), (b), and (c).
- (2) A lawyer shall, from the date of receipt of all securities and other properties held for the benefit of client or other person* through the period ending five years from the date of appropriate disbursement of such securities and other properties, maintain a written* journal that specifies:
 - (a) each item of security and property held;
 - (b) the person* on whose behalf the security or property is held;
 - (c) the date of receipt of the security or property;
 - (d) the date of distribution of the security or property; and

COMMISSION PROVISIONAL REPORT AND RECOMMENDATION: RULE 1.15 [4-100]

- (e) person* to whom the security or property was distributed.

Comment

[1] Whether a lawyer owes a contractual, statutory or other legal duty under paragraph (a) to hold funds on behalf of a person* other than a client in situations where client funds are subject to a third-party lien will depend on the relationship between the lawyer and the third-party, whether the lawyer has assumed a contractual obligation to the third person* and whether the lawyer has an independent obligation to honor the lien under a statute or other law. In certain circumstances, a lawyer may be civilly liable when the lawyer has notice of a lien and disburses funds in contravention of the lien. See *Kaiser Foundation Health Plan, Inc. v. Aguiluz* (1996) 47 Cal.App.4th 302 [54 Cal.Rptr.2d 665]. However, civil liability by itself does not establish a violation of this Rule. Compare *Johnstone v. State Bar of California* (1966) 64 Cal.2d 153, 155-156 [49 Cal.Rptr. 97] (“When an attorney assumes a fiduciary relationship and violates his duty in a manner that would justify disciplinary action if the relationship had been that of attorney and client, he may properly be disciplined for his misconduct.”) and *Crooks v. State Bar* (1970) 3 Cal.3d 346, 358 [90 Cal.Rptr. 600] (lawyer who agrees to act as escrow or stakeholder for a client and a third-party owes a duty to the nonclient with regard to held funds).

[2] As used in this Rule, “advances for fees” means a payment intended by the client as an advance payment for some or all of the services that the lawyer is expected to perform on the client's behalf. With respect to the difference between a true retainer and a flat fee, which is one type of advance fee, see Rule 1.5(d) and (e). Subject to Rule 1.5, a lawyer or law firm* may enter into an agreement that defines when or how an advance fee is earned and may be withdrawn from the client trust account.

[3] Absent written* disclosure and the client's agreement in a writing* signed by the client as provided in paragraph (b), a lawyer must deposit a flat fee paid in advance of legal services in the lawyer's trust account. Paragraph (b) does not apply to advance payment for costs and expenses. Paragraph (b) does not alter the lawyer's obligations under paragraph (d) or the lawyer's burden to establish that the fee has been earned.

IV. PROPOSED RULE 1.15 (REDLINE TO CURRENT RULE 4-100)

~~Rule 4-100 Preserving Identity of~~ 1.15 Safekeeping Funds and Property of a Client ~~Clients and Other Persons~~

- (a) All funds received or held by a lawyer or law firm* for the benefit of ~~clients by a member or law firm~~ a client, or other person* to whom the lawyer owes a contractual, statutory, or other legal duty, including advances for fees, costs and expenses, shall be deposited in one or more identifiable bank accounts ~~labeled~~ labelled “Trust ~~Account,~~” “~~Client's Funds~~ Account” or words of similar import, maintained in the State of California, or, with written* consent of the client, in any other jurisdiction where there is a substantial* relationship between the client or the client's business and the other jurisdiction. ~~No funds~~
- (b) Notwithstanding paragraph (a), a flat fee paid in advance for legal services may be

**COMMISSION PROVISIONAL REPORT AND RECOMMENDATION:
RULE 1.15 [4-100]**

deposited in a lawyer's or law firm's operating account, provided:

- (1) The lawyer or law firm* discloses to the client in writing* (i) that the client has a right under paragraph (a) to require that the flat fee be deposited in an identified trust account until the fee is earned, and (ii) that the client is entitled to a refund of any amount of the fee that has not been earned in the event the representation is terminated or the services for which the fee has been paid are not completed, and
- (2) The client's agreement to deposit the flat fee in the lawyer's operating account and the disclosures required by paragraph (b)(1) are set forth in a writing* signed by the client.

~~(A)~~(c) Funds belonging to the memberlawyer or the law firm shall not be deposited ~~therein~~ or otherwise commingled ~~therewith~~ with funds held in a trust account except ~~as follows~~:

- (1) ~~Funds~~funds reasonably* sufficient to pay bank charges.
- (2) ~~In the case of~~ funds belonging in part to a client or other person* and in part presently or potentially to the memberlawyer or the law firm,* in which case the portion belonging to the memberlawyer or law firm* must be withdrawn at the earliest reasonable* time after the member'slawyer or law firm's interest in that portion becomes fixed. However, ~~when the right of the member~~ if a client or other person* disputes the lawyer or law ~~firm~~firm's right to receive a portion of trust funds ~~is disputed by the client~~, the disputed portion shall not be withdrawn until the dispute is finally resolved.

~~(B)~~(d) A memberlawyer shall:

- (1) ~~Promptly~~promptly notify a client or other person of the receipt of ~~the client's~~ funds, securities, or other ~~properties~~property in which the lawyer knows or reasonably should know the client or other person has an interest;
- (2) ~~Identify~~identify and label securities and properties of a client or other person* promptly upon receipt and place them in a safe deposit box or other place of safekeeping as soon as practicable~~;~~;
- (3) ~~Maintain~~maintain complete records of all funds, securities, and other ~~properties~~property of a client or other person* coming into the possession of the memberlawyer or law firm* ~~and render appropriate accounts to the client regarding them~~;
- (4) promptly account in writing* to the client or other person* for whom the lawyer holds funds or property;
- (5) preserve ~~such~~ records of all funds and property held by a lawyer or law firm* under this Rule for a period of no less than five years after final appropriate distribution of such funds or ~~properties~~property; ~~and~~

COMMISSION PROVISIONAL REPORT AND RECOMMENDATION: RULE 1.15 [4-100]

~~(3)~~(6) comply with any order for an audit of such records issued pursuant to the Rules of Procedure of the State Bar.

(7) promptly distribute, as requested by the client or other person,* any undisputed funds or property in the possession of the lawyer or law firm* that the client or other person* is entitled to receive.

~~(4) — Promptly pay or deliver, as requested by the client, any funds, securities, or other properties in the possession of the member which the client is entitled to receive.~~

~~(C)~~(e) The Board of ~~Governors~~Trustees of the State Bar shall have the authority to formulate and adopt standards as to what “records” shall be maintained by ~~members~~lawyers and law firms* in accordance with subparagraph(~~Bd~~)(3). The standards formulated and adopted by the Board, as from time to time amended, shall be effective and binding on all ~~members~~lawyers.

Standards:

Pursuant to ~~rule 4-100(C)~~this Rule, the Board of ~~Governors~~Trustees of the State Bar adopted the following standards, effective ~~January 1, [1993]~~_____, as to what “records” shall be maintained by ~~members~~lawyers and law firms* in accordance with subparagraph (~~Bd~~)(3).

- (1) A ~~member~~lawyer shall, from the date of receipt of ~~client~~of the client or other person* funds through the period ending five years from the date of appropriate disbursement of such funds, maintain:
 - (a) a written* ledger for each client or other person* on whose behalf funds are held that sets forth:
 - (i) the name of such client or other person,
 - (ii) the date, amount and source of all funds received on behalf of such client or other person,
 - (iii) the date, amount, payee and purpose of each disbursement made on behalf of such client or other person,* and
 - (iv) the current balance for such client or other person;
 - (b) a written* journal for each bank account that sets forth:
 - (i) the name of such account,
 - (ii) the date, amount and client affected by each debit and credit, and
 - (iii) the current balance in such account;
 - (c) all bank statements and ~~canceled~~cancelled checks for each bank account; and

COMMISSION PROVISIONAL REPORT AND RECOMMENDATION: RULE 1.15 [4-100]

- (d) each monthly reconciliation (balancing) of (a), (b), and (c).
- (2) A ~~member~~lawyer shall, from the date of receipt of all securities and other properties held for the benefit of client or other person* through the period ending five years from the date of appropriate disbursement of such securities and other properties, maintain a written* journal that specifies:
- (a) each item of security and property held;
 - (b) the person* on whose behalf the security or property is held;
 - (c) the date of receipt of the security or property;
 - (d) the date of distribution of the security or property; and
 - (e) person* to whom the security or property was distributed.

Comment

[1] Whether a lawyer owes a contractual, statutory or other legal duty under paragraph (a) to hold funds on behalf of a person* other than a client in situations where client funds are subject to a third-party lien will depend on the relationship between the lawyer and the third-party, whether the lawyer has assumed a contractual obligation to the third person* and whether the lawyer has an independent obligation to honor the lien under a statute or other law. In certain circumstances, a lawyer may be civilly liable when the lawyer has notice of a lien and disburses funds in contravention of the lien. See *Kaiser Foundation Health Plan, Inc. v. Aquiluz* (1996) 47 Cal.App.4th 302 [54 Cal.Rptr.2d 665]. However, civil liability by itself does not establish a violation of this Rule. Compare *Johnstone v. State Bar of California* (1966) 64 Cal.2d 153, 155-156 [49 Cal.Rptr. 97] (“When an attorney assumes a fiduciary relationship and violates his duty in a manner that would justify disciplinary action if the relationship had been that of attorney and client, he may properly be disciplined for his misconduct.”) and *Crooks v. State Bar* (1970) 3 Cal.3d 346, 358 [90 Cal.Rptr. 600] (lawyer who agrees to act as escrow or stakeholder for a client and a third-party owes a duty to the nonclient with regard to held funds).

[2] As used in this Rule, “advances for fees” means a payment intended by the client as an advance payment for some or all of the services that the lawyer is expected to perform on the client's behalf. With respect to the difference between a true retainer and a flat fee, which is one type of advance fee, see Rule 1.5(d) and (e). Subject to Rule 1.5, a lawyer or law firm* may enter into an agreement that defines when or how an advance fee is earned and may be withdrawn from the client trust account.

[3] Absent written* disclosure and the client's agreement in a writing* signed by the client as provided in paragraph (b), a lawyer must deposit a flat fee paid in advance of legal services in the lawyer's trust account. Paragraph (b) does not apply to advance payment for costs and expenses. Paragraph (b) does not alter the lawyer's obligations under paragraph (d) or the lawyer's burden to establish that the fee has been earned.

COMMISSION PROVISIONAL REPORT AND RECOMMENDATION: RULE 1.15 [4-100]

V. OCTC / STATE BAR COURT COMMENTS

- **GREGORY DRESSER, OCTC, 5/19/2016:**

Please see OCTC's March 25, 2016 comment.

- **JAYNE KIM, OCTC, 4/28/2016:**

Please see OCTC's March 25, 2016 comment.

Additionally, OCTC notes the recent case of *In re Scheer* (Ninth Circuit 2016) _ Fed.3d __, 2016 WL 1459217, where the Ninth Circuit Court of Appeal ruled that an attorney may avail herself of bankruptcy protection to avoid refunding improperly collected attorney fees. [Footnote: *In Scheer*, the fees were received in violation of the prohibition against advance fees in loan modification matters. This ruling, however, could logically apply to all advance and unearned fees.] This is an example of a risk clients assume when they provide an attorney fees that may never be earned and why rule 4-100 should clarify whether such payments are to be held in trust until earned.

- **JAYNE KIM, OCTC, 3/25/2016:**

The question of whether advance attorney fees must be maintained in trust until earned is an unsettled issue in California. (Compare *T&R Foods, Inc. v. Rose* (1996) 47 Cal.App. 4th Supp. 1, 6-7, [advanced fees are funds received or held for the benefit of the client and, therefore, must be deposited into a trust account] and *Barnowski v. State Bar* (1979) 24 Cal.3d 153, 164, where the court declined to resolve the issue.) *The California Practice Guide: Professional Responsibility*, sections 9:108-109, states that the issue is unresolved, but finds that the language of the rule “seems broad enough to cover fees paid in advance” and that “prudence dictates treating such funds as the client’s property and keeping them in a trust account until fixed or earned.” Many jurisdictions have found that advance fees must be deposited into a client trust account until earned and fixed. (See *Iowa Supreme Court Board of Professional Ethics and Conduct v. Apland* (Iowa 1998) 577 N.W.2d 50, 55 [majority of authorities now agree advance fees must be deposited into trust account]; *In re Sather* (Colo 2000) 3 P.3d 403, 409; and *In re Mance* (D.C. 2009) 980 A.2d 1196, 1203.) A revision of rule 4-100 expressly resolving this question would be of benefit to the membership.

It would also be advisable for subsection (B)(3) of the rule to clarify that the accounting required under that rule be provided to the client in writing. Oral accountings are fleeting. Clients should not be expected to retain an accounting in their heads. (See *Chambers v. Kay* (2002) 29 Cal.4th 142, 157 [a client should not be expected to mentally retain fee sharing agreement information throughout the pendency of the case].) Further, clients should be able to take an accounting home and carefully review it, potentially with another trusted person. A written accounting protects the client.

- **State Bar Court:** No comments received from State Bar Court.

COMMISSION PROVISIONAL REPORT AND RECOMMENDATION: RULE 1.15 [4-100]

VI. COMPARISON OF PROPOSED RULE TO APPROACHES IN OTHER JURISDICTIONS (NATIONAL BACKDROP)

Model Rule 1.15 Variations. The ABA State Adoption Chart, entitled “Variations of the ABA Model Rules of Professional Conduct, Rule 1.15: Safekeeping Property,” revised January 5, 2016, is available at:

- http://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/mrpc_1_15.authcheckdam.pdf [Last visited 3/15/16]
- Three jurisdictions have adopted Model Rule 1.15 verbatim.¹ Fourteen jurisdictions have adopted a slightly modified version of Model Rule 1.15.² Thirty-four jurisdictions have adopted a version of the rule that is substantially different from Model Rule 1.15.³ Some jurisdictions have adopted more than one rule to regulate lawyer trust accounts. (See, e.g., Delaware rules 1.15 and 1.15A, available at: <http://courts.delaware.gov/rules/DLRPCwithCommentsFeb2010.pdf> [Last visited 3/15/16].

VII. CONCEPTS ACCEPTED/REJECTED; CHANGES IN DUTIES; NON-SUBSTANTIVE CHANGES; ALTERNATIVES CONSIDERED

A. Concepts Accepted (Pros and Cons):

1. Recommend retaining the basic structure of current rule 4-100 but breaking out some paragraphs for clarity and changing the rule title. The title is changed from “Preserving Identity of Funds and Property of a Client” to “Safekeeping Funds and Property of Clients and Other Persons”
 - Pros: There is no evidence that there is anything wrong with the basic structure of rule 4-100, which in paragraph (A) describes where funds and property subject to the rule must be placed and in paragraph (B) sets forth duties a lawyer has regarding notice, accounting, and distribution of the funds and property. However, the Commission recommends that for clarity, (i) the two sentences of paragraph (A) be split into separate paragraphs and (ii) the several clauses of paragraph (B)(3) also be split into separate subparagraphs. The title is derived from RRC1’s version on Rule 1.15, except “Handling” is changed to “Safekeeping” (from the Model Rule) and better describes the rule.
 - Cons: By separating the duty to place client funds in a trust account (proposed (a)) from the duty to not commingle funds (proposed (b)), double charging for the same

¹ The three are jurisdictions are: Kansas, Nebraska, and Rhode Island.

² The fourteen jurisdictions are: Alaska, Arizona, District of Columbia, Georgia, Iowa, Kentucky, Maryland, Montana, Nevada, New Hampshire, New Jersey, New Mexico, Vermont, and West Virginia.

³ The thirty-four jurisdictions are: Alabama, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Hawaii, Idaho, Illinois, Indiana, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, Wisconsin, and Wyoming.

COMMISSION PROVISIONAL REPORT AND RECOMMENDATION: RULE 1.15 [4-100]

misconduct (such as deposit of client trust funds in a lawyer's personal bank account) could result. Maintaining as a single paragraph current rule 4-100(A), which encompasses both duties, would avoid such a result.

2. Recommend adoption of a requirement that advance fees be placed in the lawyer's trust account.

- Pros: Including this requirement in the rule would be client protective. It is hornbook law that a fee is not earned until the lawyer has completed the agreed services or has otherwise earned the fee. A lawyer should be required to place advance fees in the trust account from which fees may be withdrawn only when the lawyer has earned the fee and the lawyer's interest in the fee has been fixed (i.e., there is no dispute as to the lawyer's entitlement to the fee. This will prevent lawyers from placing the fee in the lawyer's operating account and exhausting the funds before the funds are earned. . In the event the lawyer is discharged, the unearned fees remaining in the trust account will be available for refund. This is the rule in the majority of the states and there is no valid justification for California to provide less public protection. Lawyers have a duty to account for advance fees in any event. To the extent that some lawyers rely upon flat fees paid in advance, a benchmark approach in fee agreements can be used that would accommodate the competing interests of protecting clients and allowing for the freedom to contract.
- Cons: Whether to require that advance fees be placed in the lawyer's trust account, as is required in Model Rule 1.15 and most jurisdictions that have adopted the Model Rules, is a policy issue that has generated substantial controversy among different practice groups (e.g., bankruptcy, criminal defense lawyers) whenever it has been raised. Retaining the language of the current rule would maintain the status quo. To make the revision would effect a significant change in the law. There has been no clear signal since the Supreme Court decided *Baranowski v. State Bar* (1979) 24 Cal.3d 153 that the law should be changed. Moreover, much of the alleged abuse derives from lawyers who purport to charge a nonrefundable or "earned on receipt" fee for fee arrangements other than a true retainer. That issue has been addressed by this Commission in its proposed Rule 1.5(d) and (e).⁴ Finally, lawyers can be

⁴ Proposed Rule 1.5(d) and (e) provide:

(d) A lawyer may make an agreement for, charge, or collect a fee that is denominated as "earned on receipt" or "non-refundable," or in similar terms, only if the fee is a true retainer and the client agrees in writing after disclosure that the client will not be entitled to a refund of all or part of the fee charged. A true retainer is a fee that a client pays to a lawyer to ensure the lawyer's availability to the client during a specified period or on a specified matter, but not to any extent as compensation for legal services performed or to be performed.

(e) A lawyer may make an agreement for, charge, or collect a flat fee for specified legal services as long as the lawyer performs the agreed upon services. A flat fee is a fee which constitutes complete payment for legal fees to be performed in the future for a fixed sum regardless of the amount of work ultimately involved and which may be paid in whole or in part in advance of the lawyer providing those services.

COMMISSION PROVISIONAL REPORT AND RECOMMENDATION: RULE 1.15 [4-100]

found liable in discipline for failing to refund unearned fees. (See, e.g., *In the Matter of Fonte* (Rev. Dept. 1994) 2 Cal. State Bar Ct., Rptr. 752, 758.)) This should be sufficient incentive for lawyers to place advance fees in the trust account without an express requirement to do so.

3. Recommend adoption of paragraph (b), which excepts from the requirement that advance fees be placed in the trust account when the lawyer has provided written disclosure to the client that the client has a right to have the fees placed in the trust account and is entitled to a refund of any unearned fees, and the client has consent in writing following disclosure.
 - Pros: The paragraph strikes a balance between concern that money in the trust account is subject to government seizure or forfeiture and the interest in the public protection afforded by a rule intended to assure that unearned fees are available for a refund to a client. Although proposed paragraph (b) permits a flat fee to be held in a law firm operating account, it does not diminish a lawyer's obligation to account for the funds or to refund any amount owing to a client due to a subsequent unexpected failure of consideration.
 - Cons: Few jurisdictions have a similar exception to the requirement that advance fees be placed in the trust account for a good reason: it substantially decreases the risk that unearned fees will not be available for return to the client. The concern with seizure or forfeiture should be addressed by a change in the laws that permit such government action, not by tinkering with the client trust account rule.
4. Recommend including in the rule the concept that under certain circumstances, a lawyer owes duties to protect funds and property of a third person.
 - Pros: This change tracks RRC1's proposed rule, Model Rule 1.15 and the rule in a number of jurisdictions. California law has held that a lawyer owes duties regarding the funds and property of third persons and the rule should expressly recognize current law. The current rule is deficient because it hides the ball and fails to provide adequate public protection. At the very least, a new comment should reveal that case extends the duties in the rule to non-clients in certain circumstances.
 - Cons: The inclusion of "other person" in the rule may cause confusion as to precisely when a lawyer owes a duty to third persons to protect their funds and property and what that duty entails. A particular problematic consequence of this change is confusion as to a lawyer's duty to honor a lien on client funds (such as statutory liens, contractual liens, medical liens and prior attorney liens) because case law demonstrates that all liens are not treated the same.
5. Recommend retaining term "law firm" in current rule 4-100(A) and throughout the rule. Neither Model Rule 1.15 nor RRC1 proposed Rule 1.15 included the concept.
 - Pros: Both "lawyer" and "law firm" should be retained in the rule to protect the public and to make it clear that the rule applies even if the lawyer is not personally in charge of the firm's trust account. See proposed Rules 5.1 – 5.3. The concerns stated in the Con section below should not materialize because the rule has not proven to have such a negative effect and California neither currently nor in the proposed rules embraces the concept of law firm discipline.
 - Cons: Contrary to the pro argument, retaining "law firm" might continue a negative effect of leading individual lawyers to erroneously believe and claim that their "law

COMMISSION PROVISIONAL REPORT AND RECOMMENDATION: RULE 1.15 [4-100]

firm" is primarily responsible for a trust accounting violation. If current Rule 4-100(A) is changed to refer only to a lawyer, then it would no longer suggest that anyone other than an individual lawyer is responsible for compliance.

6. Recommend retaining current rule 4-100(B)(1) as paragraph (d)(1) and adding the "lawyer knows or reasonably should know" standard to the notice requirement. Paragraph (d)(1) provides a lawyer shall: (1) promptly notify a client or other person of the receipt of funds, securities, or other property in which the lawyer knows or reasonably should know the client or other person has an interest."
 - Pros: With the addition in the rule of an express duty owed to "other persons," the Commission determined that the duty to give notice to such persons should be qualified by the "knows or reasonably should know" standard.
 - Cons: The current rule's unqualified duty to notify a *client* should not be qualified by the "knows or reasonably should know" language.
 7. Recommend retaining current rule 4-100(B)(2) as paragraph (d)(2). Paragraph (d)(2) provides a lawyer shall: "identify and label securities and properties of a client or other person promptly upon receipt and place them in a safe deposit box or other place of safekeeping as soon as practicable."
 - Pros: The paragraph carries forward current paragraph (B)(2) nearly verbatim. There is no indication that this provision has created any problems as currently constituted.
 - Cons: None identified.
- NOTE:** As noted, (see paragraph 1, above), the Commission determined that dividing the different clauses of current rule 4-100(B)(3) into separate subparagraphs would increase the clarity of the rule.
8. Recommend retaining the first clause of current rule 4-100(B)(3) as paragraph (d)(3), with the addition of "other person". Paragraph (d)(3) provides a lawyer shall: "(3) maintain complete records of all funds, securities, and other property of a client or other person coming into the possession of the lawyer or law firm."
 - Pros: There is no indication that this provision has created any problems as currently constituted. Further, the rule should expressly recognize that a lawyer owes duties to third persons under appropriate circumstances.
 - Cons: None identified.
 9. Recommend retaining the substance of the second clause of current rule 4-100(B)(3) as paragraph (d)(4). There are four changes: (i) the word "account" has been substituted for the phrase "render appropriate accounts," (ii) the term "other persons" has been added, (iii) the requirement that the lawyer account "in writing" has been added; and the requirement that the lawyer account "promptly" has been added.
 - Pros: Paragraph (b)(4) carries forward the substance of rule 4-100(B)(3), but specifies that it also applies to "other persons" to reflect those duties that a lawyer may owe. No substantive change is intended by the substitution of "to account" for the current phrase "render appropriate accounts," which is considered to be ambiguous. Adding the requirement that the account be in writing is client-protective. The addition of the requirement that the lawyer account "promptly" more accurately describes current law.

COMMISSION PROVISIONAL REPORT AND RECOMMENDATION: RULE 1.15 [4-100]

- Cons: None identified.
10. Recommend retaining the third clause of current rule 4-100(B)(3) as paragraph (d)(5). The clause “of all funds and property held by a lawyer or law firm under this Rule” has been added to modify the term “records.”
- Pros: The clause has been added to clarify that the duty to preserve records is limited to funds and property covered by the rule. No change in substance is intended.
 - Cons: None identified. However, paragraphs (b)(3) and (b)(5) could be combined or reordered to follow one another. (see Standards (1) and (2)).
11. Recommend retaining the fourth clause of current rule 4-100(B)(3) verbatim as paragraph (d)(6). Paragraph (d)(6) provides a lawyer shall: “(6) comply with any order for an audit of such records issued pursuant to the Rules of Procedure of the State Bar.”
- Pros: There no indication that this provision has created any problems as currently constituted.
 - Cons: None identified.
12. Recommend retaining current rule 4-100(B)(4) as paragraph (d)(7), as modified, but to add term “undisputed” to modify the term “funds or property”.
- Pros: Although the word “undisputed” does not appear in current rule 1-400(B)(4), it is implied in that provision that the lawyer need only distribute “undisputed” funds given the lawyer’s duties to hold in trust “disputed funds” set forth in current rule 1-400(A)(2) [proposed paragraph (b)(2) of this Rule.] This is a clarifying change intended simply to expressly state what is already implied in the current rule. No change in substance to the rule is intended.
 - Cons: The current language relies on the concept of “entitled to receive.” This language is adequate to encompass the concept of undisputed funds. If the language is changed, a lawyer’s duty may be ambiguous in situations where a client is entitled to receive funds but an alleged dispute by a third party causes a lawyer to improperly delay or withhold disbursement to the client.
13. Recommend retaining current rule 4-100(C) nearly verbatim as paragraph (e). The only changes to the Trustees’ enabling clause is to substitute “lawyers” for “members” and change “Governors” to “Trustees”.
- Pros: This clause is the essential enabling provision that authorizes the Board to promulgate standards regarding what records must be kept pursuant to paragraph (c)(3). It should be retained.
 - Cons: None identified.
14. Recommend adding “other persons” to the recordkeeping requirements set forth in Standards (1) and (2).
- Pros: If the lawyer owes duties to safeguard funds and property of a third person, the lawyer should also have duties to keep records regarding those funds. The standards clarify what records must be maintained and for how long.
 - Cons: None identified.

COMMISSION PROVISIONAL REPORT AND RECOMMENDATION: RULE 1.15 [4-100]

B. Concepts Rejected (Pros and Cons):

1. Include more examples in paragraph (b) of exceptions to the rule against commingling as was done by RRC1.⁵
 - Pros: The added paragraphs would provide important guidance to lawyers in an area that frequently is the subject of discipline.
 - Cons: It is unnecessary to bring the foregoing exceptions into the rule because they are addressed in case law. These exceptions are nothing more than practice pointers. To include them in a rule would constitute micromanagement and conflict with the Commission's Charter. Further, funds deposited to restore entrusted funds are not and never were the lawyer's funds; it is the client's funds that are being restored.
2. Recommend deleting "presently or potentially" as modifiers of lawyer's funds in paragraph (b)(2), which is derived from current rule 4-100(A)(2).
 - Pros: The language unnecessarily injects uncertainty into a disciplinary rule. Moreover, on balance it is confusing because it appears logically inconsistent. Paragraph (b) requires a lawyer to withdraw from the trust account funds that belong to the lawyer. A rule should not permit a lawyer to withdraw funds that "potentially" belong the lawyer.
 - Cons: The current language is helpful and promotes compliance because it alerts lawyers to the fact that the character of funds received are not static. Rather, funds belonging initially to a client (such as advances for costs) may become funds belonging to the client's lawyer once the lawyer's interest becomes fixed.
3. Include in paragraph (c)(1) the phrase "claims to have" to modify the "interest" of an "other person".
 - Pros: Including this language will appropriately broaden the rule to require the lawyer to maintain sufficient funds to satisfy claims that have not yet matured.
 - Cons: The concept is ambiguous and would unnecessarily and confusingly broaden the lawyer's duties. It is not clear how a lawyer would know when a client "claims to have" an interest in funds. It is more definite and clear to impose notice duties on a lawyer only when the lawyer knows or reasonably should know the other person *has* an interest.

⁵ RRC1 added the following exceptions to its proposed paragraph re commingling:

(2) deposits for overdraft protection that compensate exactly for the amount that the overdraft exceeds the funds on deposit plus any bank charges;

(3) the lawyer's or law firm's funds deposited to restore entrusted funds that have been improperly withdrawn;

(4) funds in which the lawyer claims an interest but which are disputed by the client or other person; or

(5) funds belonging in part to a client or other person and in part, presently or potentially, to the lawyer, but which are claimed by a third party.

COMMISSION PROVISIONAL REPORT AND RECOMMENDATION: RULE 1.15 [4-100]

C. Changes in Duties/Substantive Changes to the Current Rule:

1. Adding the concept of duties owed third persons throughout the rule is a substantive change. (See section VII.A.2, above.)
2. Qualifying the notice requirement in current rule 4-100(B)(1) by a “knows or reasonably should know” standard is a substantive change. See discussion of proposed paragraph (c)(1) in section VII.A.6, above.)
3. The addition of the requirement in paragraph (c)(4) that the lawyer account “promptly” to clients and other persons is a substantive change. (See section VII.A.9, above.)
4. If the Commission were to agree that the standards be applied to “other persons” in addition to clients, it would be a substantive change. (See section VII.A.14, above.)

D. Non-Substantive Changes to the Current Rule:

1. Substitute the term “lawyer” for “member”.
 - Pros: The current Rules’ use of “member” departs from the approach taken in the rules in every other jurisdiction, all of which use the term lawyer. The Rules apply to all non-members practicing law in the State of California by virtue of a special or temporary admission. For example, those eligible to practice pro hac vice or as military counsel. (See e.g. rules 9.40, 9.41, 9.42, 9.43, 9.44, 9.45, 9.46, 9.47, and 9.48 of the California Rules of Court.)
 - Cons: Retaining “member” would carry forward a term that has been in use in the California Rules for decades.
2. Change the rule number to conform to the ABA Model Rules numbering and formatting (e.g., lower case letters).
 - Pros: It will facilitate the ability of lawyers from other jurisdictions who are authorized by various Rules of Court to practice in California to find the California rule corresponding to their jurisdiction’s rule, thus permitting ease of determining whether California imposes different duties. It will also facilitate the ability of California lawyers to research case law and ethics opinions that address corresponding rules in other jurisdictions, which would be of assistance in complying with duties, particularly when California does not have such authority interpreting the California rule. As to the “Con” that there is a large body of case law that cites to the current rule numbers, the rule numbering was drastically changed in 1989 and there has been no apparent adverse effect. A similar change in rule numbering of the Rules of Court was implemented in 2007, also with no apparent adverse effect.
 - Cons: There is a large body of case law that cites to the current rule numbers and California lawyers are presumed to be familiar with that numbering system.
3. All recommended changes not identified in paragraph VII.C as substantive changes are non-substantive changes. (See paragraphs VII.A.1, 5, **Error! Reference source not found.**, 7, 8, and 10-13.)

E. Alternatives Considered:

None.

**COMMISSION PROVISIONAL REPORT AND RECOMMENDATION:
RULE 1.15 [4-100]**

VIII. COMMISSION RECOMMENDATION FOR BOARD ACTION

Recommendation:

That the Board of Trustees of the State Bar of California adopt proposed Rule 1.15 [4-100] in the form stated above for purposes of public comment authorization as a part of the Commission's proposed comprehensive revisions to the rules.

IX. FINAL COMMISSION VOTE/ACTION

Date of Vote: June 3, 2016

Action: Approve Rule 1.15 [4-100] black letter as revised during the meeting.

Vote: 13 (yes) – 1 (no) – 0 (abstain)

Date of Vote: June 3, 2016

Action: Approve Rule 1.15 [4-100] Comment [1] as revised during the meeting.

Vote: 12 (yes) – 1 (no) – 0 (abstain)

Date of Vote: June 3, 2016

Action: Approve Rule 1.15 [4-100] Comment [2] as revised during the meeting.

Vote: 14 (yes) – 0 (no) – 0 (abstain)