

**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or potentially to the lawyer or the law firm,\* in which case the portion belonging to the lawyer or law firm\* must be withdrawn at the earliest reasonable\* time after the lawyer or law firm's interest in that portion becomes fixed.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person\* disputes the lawyer or law firm's right to receive a portion of trust funds, the disputed portion shall not be withdrawn until the dispute is finally resolved.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.<sup>1</sup> 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

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<sup>1</sup> 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.<sup>2</sup> 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.<sup>3</sup>

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

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<sup>2</sup> 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.)

<sup>3</sup> 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.<sup>4</sup> 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.

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<sup>4</sup> 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.