Escrow Cleanup: Taking Care of the

By Matthew K. Flanagan

For all the headlines about attorneys stealing client funds, most attorneys faithfully honor their obligation to safeguard client funds and would never contemplate taking client funds or giving the funds to anyone who should not receive them. As a result, many attorneys are left holding funds that no one else seems to want. This article will discuss ways in which attorneys can transfer abandoned funds from their escrow accounts while avoiding liability to former clients and third parties.

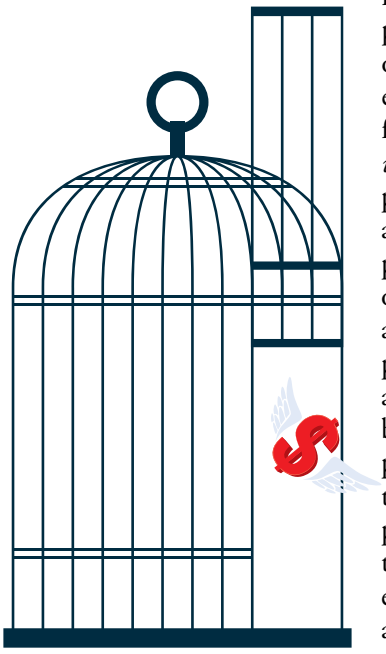
GUIDING PRINCIPLES

The Court of Appeals has noted that "[f]ew, if any, of an attorney's professional obligations are as crystal clear as the duty to safeguard client funds."[1] There are times, however, when a client seems content to let the attorney safeguard the funds for all eternity. There are other times when an attorney is left holding money while others battle over who is entitled to it.

When a client goes missing, leaving his or her funds in the attorney's escrow account, Rule 1.15(f) of the Rules of Professional Conduct[2] provides the solution. Where the money is received by the attorney as a result of an action commenced in New York State, the attorney should apply in the county in which the action was brought for "an order directing payment to the lawyer of any fees and disbursements that are owed by the client and the balance, if any, to the Lawyers' Fund for Client Protection for safeguarding and disbursement to persons who are entitled thereto."[3] Where the money was not received in connection with an action, the lawyer should apply for such an order to the Supreme Court in the county in which he or she maintains an office.

The interests of third parties in the client funds should not be ignored. Indeed, the reason the client may have walked away from any recovery may be that the net recovery to the client was insignificant. Under Rule 1.15(c)(1),[4] where a lawyer receives funds in which a client has an interest, he or she must promptly notify the client, but the duty to notify does not stop with the client. The same rule also requires the lawyer to notify any third party who has an interest in the funds. Similarly, Rule 1.15(c)(4) requires the attorney to "promptly pay or deliver" the funds to not only the client, but to any third parties who are entitled to receive them.[5]

An attorney can be held liable for disregarding a third party's claim of an interest in client funds. In *Leon v. Martinez*,[6] a plaintiff in a personal injury matter assigned part of his recovery to one of his caretakers. The attorney representing the plaintiff was aware of the assignment (he drafted it), but when the settlement proceeds arrived, neither the attorney nor his client paid any of the proceeds to the caretaker. The caretaker then sued the attorney and his firm. In finding



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Money Left Behind

that the caretaker had stated a cause of action against the attorney, the Court of Appeals noted that Disciplinary Rule 9-102 (the predecessor to Rule 1.15(c)(4)) "explicitly creates ethical duties running to third parties as to funds in the possession of the attorney to which those third parties are entitled."[7]

Courts have held that there is no duty to inquire as to possible third-party claims on funds received by an attorney on behalf of his or her client,[8] but known, non-frivolous claims must be addressed,[9] and an attorney will be deemed to have knowledge of statutory liens.

Once it is determined that the client funds do, indeed, belong to the missing client and not a third party, then how the attorney proceeds may depend on the amount at issue.

DISPOSING OF MISSING CLIENTS' FUNDS OF LESS THAN $1,000

When, as is often the case, the money left behind by the missing client is less than the cost of an index number, there is little incentive for the attorney to file an action to obtain an order permitting the attorney to pay the money to the Lawyers' Fund for Client Protection. Several years ago, an Erie County attorney found himself in just such a situation and inquired of the Erie County Ethics Committee as to what he should do. The Ethics Committee responded by quoting Disciplinary Rule 9-102(F) (the predecessor to Rule 1.15(f)), but then suggested a solution which did not comport with the rule. The Committee suggested that the attorney simply remit the amount to the Lawyers' Fund without a court order. The Committee noted that the Lawyers' Fund accepts sums of up to $1,000 from a lawyer with a missing client without a court order.[10]

If there was any doubt that the Lawyers' Fund would accept the funds without a court order, it was laid to rest when the Lawyer's Fund's posted the Erie County Ethics Committee's opinion on its website, where it remains today. The Lawyers' Fund's policy of accepting missing client funds of less than $1,000 without a court order is eminently reasonable, but the payment of the money, no matter the amount, without a court order does not comport with the plain terms of Rules 1.15(f). For the sake of consistency, the drafters of the Rules of Professional Conduct may want to consider revising Rule 1.15(f) to comport with the Lawyers' Fund's stated policy. That being said, there has been no reported decision holding that an attorney violated Rule 1.15(f) by remitting an amount less than $1,000 to the Lawyers' Fund for client protection without a court order, nor should there be. The money is not being disbursed or misappropriated; it is simply being transferred from one safe keeper to another, with the latter being a security fund administered by trustees appointed by the Court of Appeals.[11] A missing client who resurfaces years later should be able to make a claim with the Lawyers' Fund, although the manner in which he or she can do so is not entirely clear.[12]

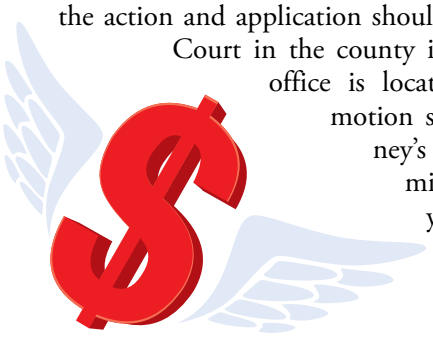
Other options for handling negligible sums left behind include filing the petition or motion contemplated by Rule 1.15(f) or simply allowing the money to remain in the attorney's escrow account. At some point, the aggregate sum of missing clients' funds in an attorney's Interest on Lawyers' Account (IOLA) may reach a level that merits an application for an order directing the attorney to pay the money to the Lawyers' Fund. That is what happened with a Garden City firm that found itself with more than $67,000 in unclaimed funds. The firm had handled hundreds of real estate closing transactions for various lenders over the course of nine years and had issued checks that were never cashed or deposited by the payees.[13] An attorney can also wait until he or she retires to clear the missing client funds out of the escrow account, as one Dutchess County attorney did when he retired after 50 years of practicing law.[14]

There is no penalty for maintaining missing clients' funds in an attorney's IOLA account, but there is rarely any benefit to doing so. The attorney looking to rid himself of missing client's funds of less than $1,000 can, after

reasonable efforts to locate the client have failed, remit the funds to the Lawyers' Fund for Client Protection.

DISPOSING OF MISSING CLIENTS' FUNDS IN EXCESS OF $1,000

Where the client is missing, the amount is more than $1,000, and there are no known third parties with an interest in the funds, the attorney should file the motion or petition, pursuant to Rule 1.15(f), for an order directing payment to the lawyer of any fees and disbursements that are owed by the client, and the balance, if any, to the Lawyers' Fund for Client Protection. As noted above, where the funds are received as a result of an action previously commenced, the motion should be made to the court in which the action was pending. Otherwise, the action and application should be made in Supreme Court in the county in which the attorney's office is located. The petition and motion should detail the attorney's efforts to locate the missing client. The Lawyers' Fund for Client Protection provides forms on its website for the convenience of attorneys.[15]



Where the missing client's entitlement to the funds is questioned by a third party, the attorney should commence an action of interpleader pursuant to CPLR 1006, followed by a motion permitting the attorney to pay the money into court and receive a discharge of liability.[16] The motion pursuant to CPLR 1006 should include a request for fees and expenses incurred by the attorney. When money is held pursuant to an escrow agreement, the agreement may provide for the escrow agent to recover reasonable fees incurred in filing an interpleader action, but even in the absence of such an agreement, courts have discretion to award the stakeholder attorney fees under CPLR 1006.[17]

Finally, it will take some time to determine that a former client cannot be located. The attorney, when he or she initially received the client's funds, may have decided to place the funds in an IOLA account, rather than a separate interest-bearing escrow account. The decision may have been reasonable at the time because the attorney did not anticipate holding the funds for very long and there was no agreement requiring the attorney to place the funds into a separate interest-bearing account. Ordinarily, an attorney's good faith decision to place client funds in an IOLA account rather than an interest-bearing account is not actionable,[18] but there have been instances of clients complaining that an attorney should have transferred the funds to an interest-bearing account when it appeared that he would be holding them for several years.[19] It is rare that an attorney would be held liable for a good faith decision to place funds in an IOLA account, but if the amount is significant and it appears that the money will be held for some time while efforts are made to locate a client or while parties claiming an interest in the funds are litigating, some thought should be given to transferring the funds to an interest-bearing account. It may help head off a complaint in the future.

CONCLUSION

In conducting periodic reviews of the escrow account, attorneys and firms should identify funds that may have been left behind. If the clients or third parties who may be entitled to the funds cannot be located after diligent efforts, then the attorney or firm can remit the funds to the Lawyers' Fund for Client Protection. If the amount is less than $1,000, the attorney can remit the amount to the Lawyers' Fund without a court order, although a revision to Rule 1.15(f) to reflect this option would be helpful. If the amount is more than $1,000, then the missing client funds should be remitted to the Lawyers' Fund for Client Protection only after the attorney obtains a court order permitting the attorney to do so. Regardless of the amount at issue, where third parties claim an interest in the funds, an interpleader action should be commenced, or the third parties should be given notice of any applications made pursuant to Rule 1.15(f).

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1. *In re Gallasso*, 19 N.Y.3d 688, 694 (2012).
2. 22 N.Y.C.R.R. § 1200.0, Rule 15(f).
3. *Id.*
4. 22 N.Y.C.R.R. 1200.0, Rule 1.15(c)(1).
5. 22 N.Y.C.R.R. 1200.0, Rule 1.15(c)(4).
6. 84 N.Y.2d 83 (1994).
7. *Id.* at 90.
8. *See Ehrlich v. Froelich*, 19 Misc. 3d 1130(A), at *3 (Nassau Co. May 6, 2008), *aff'd*, 72 A.D.3d 1010, (2d Dep't 2010) (rejecting argument that attorney had a "duty to inquire with regard to any conditions . . . on the wired funds merely because it was placed in [the] attorney trust account").
9. 22 N.Y.C.R.R. 1200.0, Rule 1.15(c)(4).
10. Erie County Ethics Opinion 04-01(2004).
11. *See* Judiciary Law § 468-b (McKinney 2018).
12. The "absence of specifically applicable statutory or regulatory provisions" regarding "claims made against missing-client funds" was discussed by the court in *Vega v. Academy Express, LLC*, 38 Misc. 3d 337 (Kings Co., 2012).
13. *See In re Application of Burns, Russo, Tamigi & Reardon, LLP Pursuant to 22 N.Y.C.R.R. Part 1200, Rule 1.15(f) for the Release of Escrow Funds*, No. 14301/2012 (Nassau County 2012).
14. *See In re Application of Thomas A. Reed Pursuant to 22 N.Y.C.R.R. Part 1200, Rule 1.15 for the Release of Escrow Funds From an IOLA Account*, No. 0005095/2012 (Dutchess Co. 2012).
15. *See* www.nylawfund.org.
16. *See* CPLR 1006(f), which provides that a stakeholder "may move for an order discharging him from liability in whole or in part to any party."
17. *See Republic National Bank of N.Y. v. Lupo*, 215 A.D.2d 467 (2d Dep't 1995).
18. *See* Judiciary Law § 497(5) ("No attorney or law firm shall be liable in damages nor held to answer for a charge of professional misconduct because of a deposit of moneys to an IOLA account pursuant to a judgment in good faith that such moneys were qualified funds.").
19. *See Mann v. Skidmore*, 2 Misc. 3d 50 (App. Term, 9th and 10th Jud. Districts, 2003); *Takayma v. Schaefer*, 240 A.D.2d 21, 27 (2d Dep't 1998) (Luciano, J., dissenting).