

RULE 1.15 SAFEKEEPING PROPERTY
Delaware Lawyers' Rules of Professional Conduct

[Effective January 1, 2004]

(a) A lawyer shall hold property of clients or third persons that is in a lawyer's possession in connection with a representation separate from the lawyer's own property. Funds shall be kept in a separate account maintained in the state where the lawyer's office is situated, or elsewhere with the consent of the client or third person. Funds of the lawyer that are reasonably sufficient to pay bank charges may be deposited therein; however, such amount may not exceed \$500 and must be separately stated and accounted for in the same manner as clients' funds deposited therein. Other property shall be identified as such and appropriately safeguarded. Complete records of such account funds and other property shall be kept by the lawyer and shall be preserved for a period of five years after the completion of the events that they record.

(b) Upon receiving funds or other property in which a client or third person has an interest, a lawyer shall promptly notify the client or third person. Except as stated in this Rule or otherwise permitted by law or by agreement with the client, a lawyer shall promptly deliver to the client or third person any funds or other property that the client or third person is entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding such property.

(c) When in the course of representation a lawyer is in possession of property in which both the lawyer and another person claim interests, the property shall be kept separate by the lawyer until there is an accounting and severance of their interests. If a dispute arises concerning their respective interests, the portion in dispute shall be kept separate by the lawyer until the dispute is resolved.

(d) A lawyer engaged in the private practice of law must maintain financial books and records on a current basis, and shall preserve the books and records for at least five years following the completion of the year to which they relate, or, as to fiduciary books and records, five years following the completion of that fiduciary obligation. The maintenance of books and records must conform with the following provisions:

(1) All bank statements, cancelled checks, and duplicate deposit slips relating to fiduciary and non-fiduciary accounts must be preserved.

(2) Bank accounts and related statements, checks, deposit slips, and other documents maintained for fiduciary funds must be specifically designated as "Trust Account" or "Escrow Account," and must be used only for funds held in a fiduciary capacity.

(3) Bank accounts and related statements, checks, deposit slips, and other documents maintained for non-fiduciary funds must be specifically designated as "Attorney Business Account" or "Attorney Operating Account," and must be used only for funds held in a non-fiduciary capacity. A lawyer in the private practice of law shall maintain a non-fiduciary account for general operating purposes, and the account shall be separate from any of the lawyer's personal or other accounts.

(4) All records relating to property other than cash received by a lawyer in a fiduciary capacity shall be maintained and preserved. The records must describe with specificity the identity and location of such property.

(5) All billing records reflecting fees charged and other billings to clients or other parties must be maintained and preserved.

(6) Cash receipts and cash disbursement journals must be maintained and preserved for each bank account for the purpose of recording fiduciary and non-fiduciary transactions. A lawyer using a manual system for such purposes must total and balance the transaction columns on a monthly basis.

(7) A monthly reconciliation for each bank account, matching totals from the cash receipts and cash disbursement journals with the ending check register balance, must be performed. The reconciliation procedures, however, shall not be required for lawyers using a computer accounting system or a general ledger.

(8) The check register balance for each bank account must be reconciled monthly to the bank statement balance.

(9) With respect to all fiduciary accounts:

(A) A subsidiary ledger must be maintained and preserved with a separate account for each client or third party in which cash receipts and cash disbursement transactions and monthly balances are recorded.

(B) Monthly listings of client or third party balances must be prepared showing the name and balance of each client or third party, and the total of all balances.

(C) No funds disbursed for a client or third party must be in excess of funds received from that client or third party. If, however, through error funds disbursed for a client or third party exceed funds received from that client or third party, the lawyer shall transfer funds from the non-fiduciary account in a timely manner to cover the excess disbursement.

(D) The reconciled total cash balance must agree with the total of the client or third party balance listing. There shall be no unidentified client or third party funds. The bank reconciliation for a fiduciary account is not complete unless there is agreement with the total of client or third party accounts.

(E) If a check has been issued in an attempt to disburse funds, but remains outstanding (that is, the check has not cleared the trust or escrow bank account) six months or more from the date it was issued, a lawyer shall promptly take steps to contact the payee to determine the reason the check was not deposited by the payee, and shall issue a replacement check, as necessary and appropriate. With regard to abandoned or unclaimed trust funds, a lawyer shall comply with the requirements of Supreme Court Rule 73.

(F) No funds of the lawyer shall be placed in or left in the account except as provided in Rule 1.15(a).

(G) When a separate real estate bank account is maintained for settlement transactions, and when client or third party funds are received but not yet disbursed, a listing must be prepared on a monthly basis showing the name of the client or third party, the balance due to each client or third party, and the total of all such balances. The total must agree with the reconciled cash balance.

(10) If a lawyer maintains financial books and records using a computer system, the lawyer must cause to be printed each month a hard copy of all monthly journals, ledgers, reports, and reconciliations, and must review and preserve the documents in the same manner as other financial records described in this Rule.

(e) A lawyer's financial books and records must be subject to examination by the auditor for the Lawyers' Fund for Client Protection, for the purpose of verifying the accuracy of a certificate of compliance filed each year by the lawyer pursuant to Supreme Court Rule 69. The examination must be conducted so as to preserve, insofar as is consistent with these Rules, the confidential nature of the lawyer's books and records. If the lawyer's books and records are not located in Delaware, the lawyer may have the option either to produce the books and records at the lawyer's office in Delaware or to produce the books and records at the location outside of Delaware where they are ordinarily located. If the production occurs outside of Delaware, the lawyer shall pay any additional expenses incurred by the auditor for the purposes of an examination.

(f) A lawyer holding client funds must initially and reasonably determine whether the funds should or should not be placed in an interest-bearing depository account for the benefit of the client. In making such a determination, the lawyer must consider the financial interests of the client, the costs of establishing and maintaining the account, any tax reporting procedures or requirements, the nature of the transaction involved, the likelihood of delay in the relevant proceedings, whether the funds are of a nominal amount, and whether the funds are expected to be held by the lawyer for a short period of time. A lawyer must at reasonable intervals consider whether changed circumstances would warrant a different determination with respect to the deposit of client funds. Except as provided in these rules, interest earned on client funds placed into an interest-bearing depository account for the benefit of the client (less any deductions for service charges or other fees of the depository institution) shall belong to the client whose funds are deposited, and the lawyers shall have no right or claim to such interest.

(g) A lawyer holding client funds who has reasonably determined, pursuant to subsection (f) of this Rule, that such funds need not be deposited into an interest-bearing depository account for the benefit of the client must maintain a pooled interest-bearing depository account for the deposit of the funds; provided, however, that this requirement shall not apply to a lawyer who has obtained inactive status pursuant to Supreme Court Rule 69(d), or has obtained a Certificate of Retirement pursuant to Supreme Court Rule 69(f), or has formally elected to opt out of this requirement in accordance with the procedure set forth below in subparagraph (k).

(h) A lawyer who maintains such a pooled account shall comply with the following:

(1) The account shall include only client's funds which are nominal amount or are expected to be held for a short period of time.

(2) No interest from such an account shall be made available to a lawyer or law firm.

(3) Lawyers or law firms depositing client funds in a pooled interest-bearing account under this paragraph (h) [(g)] shall direct the depository institution:

(a) To remit interest, net any service charges or fees, as computed in accordance with the institution's standard accounting practice, at least quarterly, to the Delaware Bar Foundation; and

(b) To transmit with each remittance to the Delaware Bar Foundation a statement showing the name of the lawyer or law firm on whose accounting remittance is sent and the rate of interest applied; with a copy of statement to be transmitted to the lawyer or law firm by the Delaware Bar Foundation.

(i) The funds transmitted to the Delaware Bar Foundation shall be available for distribution for the following purposes:

(1) To improve the administration of justice;

(2) To provide and to enhance the delivery of legal services to the poor;

(3) To support law related education;

(4) For such other purposes that serve the public interest.

The Delaware Bar Foundation shall recommend for the approval of the Supreme Court of the State of Delaware, such distributions as it may deem appropriate. Distributions shall be made only upon the Court's approval.

(j) Lawyers or law firms, depositing client funds in a pooled interest-bearing depository account under this paragraph shall not be required to advise the client of such deposit or of the purposes to which the interest accumulated by reason of such deposits to be directed.

(k) The procedure available for opting out of the requirement to maintain pooled interest-bearing accounts are as follows:

(1) Prior to December 15, 1983, a lawyer wishing to decline to maintain a pooled interest-bearing account[s] described in this paragraph for any calendar year may do so by submitting a Notice of Declination in writing to the Clerk of the Supreme Court *ab initio* or before December 15 of the preceding calendar year. Any such submission shall remain effective, unless revoked and need not be renewed for any ensuing year.

(2) Any lawyer who has not filed a Notice of Declination on or before December 15, 1983, may elect not to maintain a pooled interest-bearing depository account for client funds as required and instead to maintain a pooled depository account for such funds that does not bear interest or that bears interest solely for the benefit of the clients who deposited the funds by certifying that the lawyer or law firm opts out of the obligation to comply with the requirements by timely submission of the annual Registration Statement required by Supreme Court Rule 69(b)(i). Any such certification shall release the lawyer or law firm submitting it from participation effective as of the date that the certification is submitted and it shall remain effective until revoked as set forth below without need for renewal for any ensuing year.

(3) Notwithstanding the foregoing provisions of this subparagraph, any lawyer or law firm may petition the Court at any time and, for good cause, shown, may be granted leave to opt out of the obligation to comply with the mandatory requirements of this paragraph.

(l) An election to opt out of the obligation to comply with paragraph (h) hereof may be revoked at any time upon the opening by a non-participating lawyer or law firm of a pooled interest-bearing account as previously described and due notification thereof to the Court Administrator of the Supreme Court pursuant to Supreme Court Rule 69(g).

(m) A lawyer should exercise good faith judgment in determining initially, whether funds of a client are of such nominal amount or are expected to be held by the lawyer for such a short period of time that the funds should not be placed in an interest-bearing depository account for the benefit of the client. The lawyer should also consider such other facts as:

(1) The cost of establishing and maintaining the account, service charges, accounting fees, and tax reporting procedures;

(2) The nature of the transaction(s) involved; and

- (3) The likelihood of delay in the relevant proceedings.

A lawyer should review at reasonable intervals whether changed circumstances require further action respecting the deposit of client funds.

(n) A lawyer shall not disburse Fiduciary Funds from his or her attorney trust account(s) unless the funds deposited in the account to be disbursed are good funds as hereinafter defined. "Good funds" shall mean:

- (1) Cash;
- (2) Electronic fund ("wire") transfer;
- (3) Certified check;
- (4) Bank cashier's check or treasurer's check;
- (5) U.S. Treasury or State of Delaware Treasury check;
- (6) Check drawn on a separate trust or escrow account of an attorney engaged in the private practice of law in the State of Delaware held in a fiduciary capacity, including his or her client's funds;
- (7) Check of an insurance company that is authorized by the Insurance Commissioner of Delaware to transact insurance business in Delaware;
- (8) Check in an amount no greater than \$10,000.00;
- (9) Check greater than \$10,000.00 which has been actually and finally collected and may be drawn against under federal or state banking regulations then in effect;
- (10) Check drawn on an escrow account of a real estate broker licensed by the state of Delaware up to the limit of guarantee provided per transaction by statute.

Comment

[1] A lawyer should hold property of others with the care required of a professional fiduciary. Securities should be kept in a safe deposit box, except when some other form of safekeeping is warranted by special

circumstances. All property which is the property of clients or third persons should be kept separate from the lawyer's business and personal property and, if monies, in one or more trust accounts. Separate trust accounts may be warranted when administering estate monies or acting in similar fiduciary capacities.

[2] Lawyers often receive funds from third parties from which the lawyer's fee will be paid. If there is risk that the client may divert the funds without paying the fee, the lawyer is not required to remit the portion from which the fee is to be paid. However, a lawyer may not hold funds to coerce a client into accepting the lawyer's contention. The disputed portion of the funds should be kept in trust and the lawyer should suggest means for prompt resolution of the dispute, such as arbitration. The undisputed portion of the funds shall be promptly distributed.

[3] Third parties, such as a client's creditors, may have just claims against funds or other property in a lawyer's custody. A lawyer may have a duty under applicable law to protect such third-party claims against wrongful interference by the client, and accordingly may refuse to surrender the property to the client. However, a lawyer should not unilaterally assume to arbitrate a dispute between the client and the third party.

[4] The obligations of a lawyer under this Rule are independent of those arising from activity other than rendering legal services. For example, a lawyer who serves as an escrow agent is governed by the applicable law relating to fiduciaries even though the lawyer does not render legal services in the transaction.

[5] The extensive provisions contained in Rule 1.15(d) represent the financial recordkeeping requirements that Delaware lawyers must follow when engaged in the private practice of law. These provisions are also reflected in a certificate of compliance that is included in each lawyer's registration statement, filed annually pursuant to Delaware Supreme Court Rule 69.

[6] Compliance with these provisions provides the necessary level of control to safeguard client and third party funds, as well as the lawyer's operating funds. When these recordkeeping procedures are not performed on a prompt and timely basis, there will be a loss of control by the lawyer, resulting in insufficient safeguards over client and other property.

[7] Some of the essential financial recordkeeping issues for Delaware lawyers under this Rule include the following:

(a) Segregation of funds. Improper commingling occurs when the lawyer's funds are deposited in an account intended for the holding of client and third party funds, or when client funds are deposited in an account intended for the holding of the lawyer's funds. The only exception is found in rule 1.15(a), which allows a lawyer to maintain \$500 of the lawyer's funds in the fiduciary account in order to cover possible bank service charges. Keeping an accurate account of each client's funds is more difficult if client funds are combined with the lawyer's own funds. The requirement for separate bank accounts for lawyer funds and non-lawyer funds, with separate bookkeeping procedures for each, is intended to avoid commingling.

(b) Deposits of legal fees. Unearned legal fees are the property of the client until earned, and therefore must be deposited into the lawyer's fiduciary account. Legal fees must be withdrawn from the fiduciary account and transferred to the operating or business account promptly upon being earned, to avoid improper commingling. The monthly listing of client and third party funds in the fiduciary account should therefore be carefully reviewed in order to determine whether any earned legal fees remaining in the account.

(c) Identity of property. The identity and location of client funds and other property must be maintained at all times. Accordingly, every cash receipt and disbursement transaction in the fiduciary account must be specifically identified by the name of the client or third party. If financial books and records are maintained in this manner, the resultant control should ensure that there are no unidentified funds in the lawyer's possession.

(d) Disbursement of funds. Funds due to clients or third parties must be disbursed without unnecessary delay. The monthly listing of client funds in the fiduciary account should therefore be reviewed carefully in order to determine whether any balances due to clients or third parties remain in the account.

(e) Negative balances. The disbursement of client or third party funds in an amount greater than the amount being held for such client or third party results in a negative balance in the fiduciary account. This should never occur when the proper controls are in place. However, if a negative balance occurs by mistake or oversight, the lawyer must make a timely transfer of funds from the operating account to the fiduciary account in order to cover the excess disbursement and cure the negative balance. Such mistakes can be

avoided by making certain that the client balance sufficiently covers a potential disbursement prior to making the actual disbursement.

(f) Reconciliations. Reconciled cash balances in the fiduciary accounts must agree with the totals of client balances held. Only by performing a reconciliation procedure will the lawyer be assured that the cash balance in the fiduciary account exactly covers the balance of client and third party funds that the lawyer is holding.

(g) Real estate accounts. Bank accounts used exclusively for real estate settlement transactions are fiduciary accounts, and are therefore subject to the same recordkeeping requirements as other such accounts, except that cash receipts and cash disbursements journals are not required.

[8] Illustrations of some of the accounting terms that Delaware lawyers need to be aware of, as used in this Rule, include the following:

(a) Financial books and records include all paper documents or computer files in which fiduciary and non-fiduciary transactions are individually recorded, balanced, reconciled, and totalled. Such records include cash receipts and cash disbursements journals, general and subsidiary journals, periodic reports, monthly reconciliations, listings, and so on.

(b) The cash receipts journal is a monthly listing of all deposits made during the month and identified by date, source name, and amount, and in distribution columns, the nature of the funds received, such as "fee income" or "advance from client," and so on. Such a journal is maintained for each bank account.

(c) The cash disbursements journal is a listing of all check payments made during the month and identified by date, payee name, check number, and amount, and in distribution columns, the nature of funds disbursed, such as "rent" or "payroll", and so on. Such a journal is maintained for each bank account. Cash receipts and cash disbursement records may be maintained in one consolidated journal.

(d) Totals and balances refer to the procedures that the lawyer needs to perform when using a manual system for accounting purposes, in order to ensure that the totals in the monthly cash receipts and cash disbursements journals are correct. The cash and distribution columns must be added up for each month, then the total

cash received or disbursed must be compared with the total of all of the distribution columns.

(e) The ending check register balance is the accumulated net cash balance of all deposits, check payments, and adjustments for each bank account. This balance will not normally agree with the bank balance appearing on the end-of-month bank statement because deposits and checks may not clear with the bank until the next statement period. This is why a reconciliation is necessary.

(f) The reconciled monthly cash balance is the bank balance conformed to the check register balance by taking into account the items recorded in the check register which have not cleared the bank. For example:

Account balance, per bank statement	\$2,000.00
Add – deposits in transit (deposits in check register that do not appear on bank statement)	\$1,500.00
Less – outstanding checks (checks entered in check register that do not appear on bank statement)	<u>(\$1,800.00)</u>
Reconciled cash balance	<u>\$1,700.00</u>

(g) The general ledger is a yearly record in which all of a lawyer's transactions are recorded and grouped by type, such as cash received, cash disbursed, fee income, funds due to clients, and so on. Each type of transaction recorded in the general ledger is also summarized as an aggregate balance. For example, the ledger shows cash balances for each bank account which represent the accumulation of the beginning balance, all of the deposits in the period, and all of the checks issued in the period.

(h) The subsidiary ledger is the list of transactions shown by each individual client or third party, with the individual balances of each (as contrasted to the general ledger, which lists the total balances in an aggregate amount "due to clients"). The total of all of the individual client and third party balances in the subsidiary ledger should agree with the total account balance in the general ledger.

(i) A variance occurs in a reconciliation procedure when two figures which should agree do not in fact agree. For example, a variance occurs when the reconciled cash balance in a fiduciary

account does not agree with the total of client and third party funds that the lawyer is actually holding.

[9] Accrued interest on client and other funds in a lawyer's possession is not the property of the lawyer, but is generally considered to be the property of the owner of the principal. An exception to this legal principle relates to nominal amounts of interest on principal. A lawyer must reasonably determine if the transactional or other costs of tracing and transferring such interest to the owners of the principal are greater than the amount of the interest itself. The lawyer's proper determination along these lines will result in the lawyer's depositing of fiduciary funds into an interest-bearing account for the benefit of the owners of the principal, or into a pooled interest-bearing account. If funds are deposited into a pooled account, the interest is to be transferred (with some exceptions) to the Delaware Bar Foundation pursuant to the Delaware Supreme Court's Interest On Lawyer Trust Accounts Program ("IOLTA").

[10] Implicit in the principles underlying rule 1.15 is the strict prohibition against the misappropriation of client or third party funds. Misappropriation of fiduciary funds is clearly a violation of the lawyer's obligation to safeguard client and other funds. Moreover, intentional or knowing misappropriation may also be a violation of Rule 8.4(b) (criminal conduct in the form of theft) and Rule 8.4(c) (general dishonest or deceptive conduct). Intentional or knowing misappropriation is considered to be one of the most serious acts of professional misconduct in which a lawyer can engage, and typically results in severe disciplinary sanctions.

[11] Misappropriation includes any unauthorized taking by a lawyer of client or other property, even for benign reasons or where there is an intent to replenish such funds. Although misappropriation by mistake, neglect, or recklessness is not as serious as intentional or knowing misappropriation, it can nevertheless result in severe disciplinary sanctions. See, e.g., *Matter of Figliola*, Del. Supr., 652 A.2d 1071, 1076-78 (1995).