Are You Sure You're Ready to Disburse?

By William O. Higgins

Imagine this scenario: You are a real estate lawyer, and you have just conducted a closing (yes, you, not your paralegal!). In connection with the closing, you have received an "official" bank check from your client, the purchaser, issued by All American Bank, an FDIC-insured national bank with a local branch in your town, in the amount required by the settlement statement and naming your firm as the payee. Additionally, you have received the lender's proceeds by way of a confirmed wire transfer into your IOLTA account with New Southern Bank. You deposit your client's All American Bank check into that same New Southern Bank IOLTA account, and you are ready to disburse—right? After all, the seller is certainly expecting to be paid at the closing table, and you know the real estate agent isn't leaving without a check. Plus, for you, it's much more efficient to disburse at the closing table—no need to mail or hand deliver those checks when the recipients are right there with you. But these are troubled economic times, and perhaps additional caution is warranted.

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What happens if the All American Bank check turns out to be a counterfeit, was obtained fraudulently or bears an unauthorized signature? Do you, the closing attorney, intend to bear that risk? This article is intended to alert real estate closing attorneys and any other lawyers who utilize IOLTA (or other trust) accounts of the risks associated with disbursements from such accounts.

Good funds, collected funds, available funds?

The terms "good funds" and "collected funds" are often used interchangeably to refer to funds that are available to be disbursed from a trust account.

The term "available funds" is also used with some frequency, but should be used with caution. Based on the lawyer's relationship with his or her depository bank, deposited funds of various types may be made "available" for withdrawal immediately upon deposit. The problem, however, is that "available funds" are not "collected funds." The credit

given by the depository bank for available funds is provisional only and may be revoked if the deposited item does not clear. *See* S.C. Code Ann. § 36-4-201 (2008).

For purposes of this article, the term "collected funds" is intended to refer to items that have cleared (i.e., for which final payment has been made) and for which credit is not subject to revocation. While a complete discussion of what constitutes collected funds is beyond the scope of this article, S.C. Code Ann. § 36-4-215 is instructive.

Rule 1.15(f)

Rule 1.15(f) of the South Carolina Rules of Professional Conduct (South Carolina Appellate Court Rule 407) provides a "good funds" rule that specifies what types of funds can be treated as "collected funds" for purposes of trust account disbursements. Those "equivalents" are "Cash, verified and documented electronic fund transfers, or other deposits treated by the depository institution as equivalent to cash, properly endorsed government checks, certified checks, cashiers checks or other checks drawn by a depository institution, and any other instrument payable at or through a depository institution, if the amount of such other instrument does not exceed $5,000 and the lawyer has reasonable and prudent belief that the deposit of such instrument will be collected promptly." Lawyers should be aware that Rule 1.15(f) requires that such "equivalents" must first be deposited, prior to disbursement, and that the lawyer is at risk for the actual collection of deposits of such equivalents.

An understanding of some basic terms used in Rule 1.15(f) will be helpful. A "certified check" refers to a customer's check that has been certified in writing on the check by the bank on which that customer's check is drawn. By certifying the customer's check, the bank has "accepted" the check. *See* S.C. Code Ann. § 36-3-409(d). A "cashiers check" refers to a check on which the bank is both the drawer and the drawee. *See* S.C. Code Ann. § 36-3-104(g). The phrase in Rule 1.15(f), "other checks drawn by a bank," refers to "bank checks" or "teller checks," that is to say, checks on which the bank is the drawer, and the drawee is a second bank. In all three cases (certified checks, cashiers checks and bank or teller checks), the bank incurs direct liability to the payee; consequently, a lawyer depositing one of those items into his or her trust account can normally be comfortable that there is little risk of ultimately being responsible for the non-payment of such an item (subject, of course, to whatever liquidity or other concerns the lawyer may have with respect to the bank). For further comfort as to the collection of those items, see S.C. Code Ann. § 36-3-411.

Rule 1.15(f) also allows a lawyer to treat as collected funds "any other instrument payable at or through a bank, if the amount of such other instrument does not exceed $5,000, and the lawyer has

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reasonable and prudent belief that the deposit of such instrument will be collected promptly." This "*de minimis*" rule allows a lawyer to deposit a client's (or third party's) personal check into the trust account, up to a maximum amount of $5,000, and treat the same as collected funds for purposes of immediate disbursement. While that might be a nice convenience for the party tendering the personal check, lawyers should avail themselves of this rule with caution since the burden for collection falls on the lawyer. Finally, note that Rule 1.15(f) does not include checks from lawyers' trust accounts among the list of items that may be treated as collected funds upon deposit; hence, unless the amount of the check is $5,000 or less, a lawyer may not deposit another lawyer's trust account check and immediately disburse those funds.

Careful lawyers will recognize that the list of items in Rule 1.15(f) that may be treated as collected funds does not actually elevate those items to collected funds as a matter of banking or commercial law. Rather, a completely different regime applies to the analysis of when, and under what circumstances, those items actually become collected funds in the lawyer's trust account. In other words, Rule 1.15(f) is merely a professional responsibility accommodation to lawyers that allows for prompt disbursement of deposited funds; it is not a matter of substantive law, nor a summary or restatement of substantive law.

Lawyers should also be reminded of Rule 1.15(h), which requires lawyers who maintain trust accounts to "file with the financial institution a written directive requiring the institution to report to the Commission on Lawyer Conduct when any properly payable instrument drawn on the account is presented for payment against insufficient funds."

Who bears the risk?

A detailed discussion of which party ultimately bears the risk of payment of a forged, stolen, counterfeit or insufficient funds item is beyond the scope of this article; however, as between a lawyer and the lawyer's trust account bank (New Southern Bank in our hypothetical), lawyers should be aware of S.C. Code Ann. § 36-4-214. This Section creates a charge back or refund right in favor of the trust account bank for a third-party deposited item for which it is not paid, subject to some timeliness requirements. In other words, the trust account bank is allowed to hold the funds (assuming there has been no final payment) until a determination is made as to whether the lawyer or the trust account bank must suffer the liability for noncollection. Here we have an illustration of the effect of a provisional credit. Until a provisional credit becomes final, the lawyer bears the risk of disbursements made on the basis of the item creating the provisional credit. Not only does the lawyer run the risk of a charge back by the trust account bank pursuant to S.C. Code Ann. § 36-4-214, Rule 1.15(f) requires the lawyer to deposit replacement funds promptly (no more than five working days) after receiving notice of the noncollection. Regardless of the ultimate outcome, the lawyer who has disbursed funds from the trust account on a deposit for which payment has not been received will initially bear the loss. That loss will be borne almost immediately since the last sentence of Rule 1.15(f) requires the lawyer to deposit replacement funds in the account within "five working days after notice of noncollection." Hence, even if some other solvent party ultimately bears the risk of loss, the lawyer will have borne it during the intervening period.

Wire transfers

Electronic funds transfers through the Federal Reserve wire system have gained widespread acceptance over the last 15 to 20 years as a method of funding trust account deposits. While not completely without risk, wire transfers appear to involve fewer risks from the lawyer's perspective than various paper forms of deposit. Wire transfers are governed by a separate section of the UCC (*see* S.C. Code Ann. § 36-4A-101, *et. seq.*). While there are some exceptions, generally speaking, when a lawyer receives notice from its trust account bank that a wire transfer has been received and credited to the account, that credit represents final payment of the item, and the lawyer may disburse immediately.

Conclusion

Generally, lawyers understand that they cannot disburse funds from their trust accounts that are not yet deposited; however, it is easy to be lulled into the dangerous trap

Could this happen to you?

A South Carolina attorney was engaged by a high profile, married couple to handle the closing on the acquisition of a multi-million dollar resort home on a cash basis. On the day of closing, the wife delivers to the closing attorney an "official" bank check from a well-known national bank with branches throughout South Carolina (including the area where the property was located) in the full amount required pursuant to the settlement statement. The closing attorney closes the transaction, deposits the check into his trust account, records the deed, and makes disbursements out of the trust account for seller's proceeds, seller's mortgage payoff, and various closing costs.

A few days later, the "official" check was returned, stamped "Item Returned-Counterfeit." The provisional credit to the closing attorney's trust account was reversed, thereby creating a multi-million dollar negative trust account balance.

This is a true story! Ultimately, the closing attorney was able to get a court order turning the property over to a receiver, the property was resold, and the closing attorney and the title insurance company were reimbursed. The moral of the story is that paper items such as cashier's checks or "official" bank checks are easily counterfeited, and banks are generally not in the business of honoring counterfeit items.

of believing that the collection of deposited items and the corresponding outgoing disbursements from lawyers' trust accounts involve only a timing issue, without any real risk as a matter of substantive law.

In these remarkably challenging economic times, clever thieves are targeting lawyers based on just that careless attitude about such timing. An example of a scam that specifically targets lawyers works like this: A fictitious foreign entity makes e-mail contact with the lawyer indicating the need for assistance in connection with a legal issue involving a U.S. entity. For added credibility, the e-mail references the communication as a mutual introduction (potential representation) arising from a referral from the foreign entity's regular counsel. The prospective client then informs the lawyer that a settlement of the claim is imminent and requests that the lawyer serve as settlement agent and counsel going forward. Shortly thereafter, the lawyer receives a settlement check with instructions to deposit the check into his trust account, deduct his fees from the amount deposited, and wire the balance to the foreign client. After the lawyer complies with those instructions, the check is dishonored as "counterfeit" or "fraudulent," and the lawyer is left to deal with the resulting shortfall in his trust account.

Lawyers should be very careful when accepting items for deposit into trust accounts. The better practice is to allow all trust account deposits to become collected funds before disbursing. Lawyers should be prepared to contact the drawee bank to verify the legitimacy of an instrument if there is any cause for doubt or concern. Lawyers should be extremely wary of a trust account transaction in which the incoming funds are in the form of paper instruments, but the outgoing funds are required to be disbursed immediately by way of a wire transfer. While timing of deposits versus disbursements is critical to the analysis of proper and prudent trust account management, it is not the only issue.

The lesson to be learned here extends well beyond difficult economic times and scam artists targeting lawyers. Even in good times and in connection with completely legitimate settlements or transactions, lawyers are at risk when they disburse on anything less than collected funds. The practice of law is difficult enough without lawyers bearing the risk of collection of items deposited into their trust accounts. That risk should be borne by the parties that are providing or receiving funds in connection with the settlement or transaction.

The pressure to disburse promptly is palpable to be sure, but is it really worth bearing the economic risk, time, trouble and potential disciplinary action of disbursing on uncollected funds?

William O. Higgins practices with Ellis, Lawhorne & Sims, PA in Columbia.

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NBSC Building, Suite 1200 (Corner of Main and Lady)
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Rock Hill Office:
131 Caldwell St.
Rock Hill, SC 29730
(803) 329-8656