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THE ADVANCE FEE PAYMENT DILEMMA: SHOULD PAYMENTS BE DEPOSITED TO THE CLIENT TRUST ACCOUNT OR TO THE GENERAL OFFICE ACCOUNT?

Lester Brickman*

A lawyer possessing client property is acting in a fiduciary capacity. If the property is in the form of funds, fiduciary safeguards mandate the deposit of the funds to a client trust account—a requirement that has occasioned a considerable volume of disciplinary proceedings against lawyers. Disciplinary Rule 9-102 of the Code of Professional Responsibility ("DR 9-102"), entitled "Preserving Identity of Funds,

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2 A client trust account is a separately maintained bank account that must be identified as a client or trust account and cannot be the account maintained for a lawyer's law firm or other business purposes. Funds of all clients can generally be deposited in the same trust account, in which case adequate records must be maintained of each client's interest in the account.


3 There were more than 800 disbarments and suspensions nationally between the years 1980 and 1985 as a result of violations of attorney trust accounts. The wrongs include misappropriation of client funds, poor or inadequate record keeping, embezzlement or theft of client funds, conversion of client property, commingling, and poor accounting of client funds.


4 Disciplinary Rule 9-102 states in pertinent part that:

(A) All funds of clients paid to a lawyer . . . , other than advances for costs and expenses, shall be deposited in one or more identifiable bank accounts . . . and no funds belonging to the lawyer or law firm shall be deposited therein except as follows:

(2) Funds belonging in part to a client and in part presently or potentially to the lawyer or law firm must be deposited therein, but the portion belonging to the lawyer or law firm may be withdrawn when due unless the right of the lawyer or law firm to receive it is disputed by the client, in which event the disputed portion shall not be withdrawn until the dispute is finally resolved.

(B) A lawyer shall:

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and Property of a Client," codifies several fiduciary standards: it requires an attorney to deposit client funds in a trust account, to avoid commingling client funds with the attorney's funds, and to account to the client for the funds. Commingling, which is regarded as a serious offense, occurs when an attorney intermingles his client's funds with his own, depriving the funds of their separate identity and facilitating their subjection to the attorney's personal use and to the claims of the attorney's creditors. Funds in which both the client and the attorney have a proprietary interest, such as proceeds from a contingent fee settlement or award, must also be placed in the client account until the interests are severed.

The requirements codified by DR 9-102 are imposed only if the funds belong at least in part to the client; thus, when an attorney first receives funds, a determination as to their nature and ownership must be made. If the funds are solely the attorney's property, they must be

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(1) Promptly notify a client of the receipt of his funds, securities, or other properties.
(2) Identify and label securities and properties of a client promptly ....
(3) Maintain complete records of all funds, securities, and other properties of a client coming into the possession of the lawyer and render appropriate accounts to his client regarding them.
(4) Promptly pay or deliver to the client as requested by a client the funds, securities, or other properties in the possession of the lawyer which the client is entitled to receive.


6 See Heavey v. State Bar, 17 Cal. 3d 553, 551 P.2d 1238, 131 Cal. Rptr. 406 (1976); In re Castello, 402 N.E.2d 970 (Ind. 1980); Louisiana State Bar Ass'n v. Stinson, 368 So. 2d 971 (La. 1979); In re Witherington, 88 N.J. 241, 440 A.2d 1327 (1982); Columbus Bar Ass'n v. Tuttle, 41 Ohio St. 2d, 324 N.E.2d 753 (1975); In re Rollins, 281 S.C. 467, 316 S.E.2d 670 (1984); In re Cary, 90 Wash. 2d 762, 585 P.2d 1161 (1978).


8 Model Code, supra note 4, DR 9-102(A)(2). Funds in which both the attorney and client have an interest are typically funds received by the attorney from which his fee will be paid. Examples of such funds are: judgment awards, e.g., In re Rogers, 99 Ariz. 343, 409 P.2d 45 (1965); settlement proceeds, e.g., People v. Davis, 620 P.2d 725 (Colo. 1980); In re Hartman, 61 A.D.2d 194, 401 N.Y.S.2d 547 (1978); proceeds of a sale of a client's real or personal property, e.g., Oklahoma Bar Ass'n v. Burger, 401 P.2d 524 (Okla. 1965); State ex rel. Oklahoma Bar Ass'n v. Dugger, 385 P.2d 486 (Okla. 1963); and estate proceeds, e.g., Attorney Grievance Comm'n v. Boehm, 293 Md. 476, 446 A.2d 52 (1982); In re Michaelson, 298 N.W.2d 69 (Minn. 1980); In re Thomas, 294 Or. 505, 659 P.2d 960 (1983).

deposited to his general office account;\(^\text{10}\) but if they are the client's property, in whole or in part, they must be deposited to the client trust account.\(^{11}\)

How attorney fees fit into this dichotomy depends on their characterization. When an attorney is employed to actually or potentially perform legal services, he has entered into a "retainer agreement."\(^\text{12}\) Funds paid to the attorney at the outset, under the retainer agreement, are also denominated as a "retainer." If the services being purchased are the attorney's availability to render a service if and as needed in a specified time frame, then the retainer is a "general retainer;"\(^\text{13}\) if the funds are for a specific service, then the employment relation as well as the fee is a "special retainer."\(^\text{14}\) If the attorney contracts to receive his special retainer payment in advance of performing the services, then that payment may be denominated as an "advance fee payment."\(^\text{15}\) Advance fee payments present a difficult issue\(^\text{16}\) since if they are not "funds of clients" within the meaning of DR 9-102, then depositing the funds in the client trust account violates DR 9-102(A), which mandates that funds belonging to the attorney must not be deposited in the trustee account or otherwise

\(^{10}\) A general office account contains those funds which are used either to pay expenses for operating the attorney's office or for the attorney's personal expenses.

\(^{11}\) Model Code, supra note 4, DR 9-102.

\(^{12}\) See 1 S. Speiser, Attorneys' Fees § 1:1, at 3-4 (1973).

\(^{13}\) A general retainer is a fee for agreeing to make legal services available when needed during a specified time period. In form, it is an option contract; the fee is earned by the attorney when paid since the attorney is entitled to the money regardless of whether he actually performs any services for the client. Baranowski v. State Bar, 24 Cal. 3d 153, 164 n.4, 593 P.2d 613, 618 n.4, 154 Cal. Rptr. 752, 757 n.4 (1979); see Blair v. Columbian Fireproofing Co., 191 Mass. 333, 77 N.E. 762 (1906).


\(^{15}\) An advance fee payment is a payment made by a client to the attorney prior to the performance of contemplated services. The attorney depletes the prepayment as he renders services. If the matter is completed or the attorney's work on the case otherwise ends, the attorney is obligated to refund the balance of the advance payment to the client. D.C. Bar, Op. 113, at 1 (1982); Wash. State Bar Ass'n Code of Professional Responsibility Comm., Formal Op. 173, reprinted in Wash. State Bar News 50 (Oct. 1980); Model Code, supra note 4, DR 2-110(A)(3); Model Rules, supra note 4, Rule 1.5 comment ("A lawyer may require advance payment of a fee, but is obliged to return any unearned portion."). The advance fee payment must be distinguished from the general retainer. See supra notes 12-14 and accompanying text.

\(^{16}\) See Dimitriou, Should Prepaid Fees Be Put in a Trust Account?, 3 Calif. Law. 20, 21 (1983) (Attorneys "cannot 'play it safe' by merely depositing prepaid fees in a client trust account.").
commingled with client funds except as provided by the rule. Similarly, if the attorney deposits the prepaid fees in his office account, and advance fees are "funds of clients," the attorney can be disciplined for failing to account properly to the client for the money, as well as for commingling.

Seventeen state and city bar associations and several courts (encompassing a substantial portion of the lawyers in the United States) have issued opinions on the subject. By an almost 2:1 margin, the opinions provide that advance fee payments must be deposited to the trust account. The most thorough exposition in the bar literature (and also the most recent) is the opinion of the New York State Bar Association Committee on Professional Ethics ("N.Y. 570"), which concludes that lawyers should deposit advance fee payments in their general office accounts rather than in client trust accounts, even when such payments are refundable to the extent not earned. This Article

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17 See supra note 4. Consequently, an attorney cannot even prevent overdrawing of the trust account by keeping his funds in that account because he will be guilty of commingling. Kurzer, supra note 3, at 355 n.1; see also C. Wolfram, supra note 2, § 4.8, at 177 n.1 (discussing when commingling occurs).

18 Model Code, supra note 4, DR 9-102(B).

19 See infra notes 47-48.


Opinions are categorized as majority if they hold either (1) that nonrefundable retainers are ethically valid and are therefore to be deposited to the general account since they are not "funds of clients," and also that advance fees not denominated as nonrefundable are to be deposited to a trust account; or (2) that nonrefundable retainers are unethical and all advance fee payments are to be deposited to a trust account. Opinions are categorized as minority regardless of their position on nonrefundable retainers if they hold that a refundable advance fee does not have to be deposited to a trust account.

21 N.Y. State Bar Ass'n Comm. on Professional Ethics, Op. 570 (1985) [hereinafter N.Y. 570]. However, the committee also concluded "that DR 9-102(A) does not prohibit lawyers from agreeing with their clients to treat fee advances as client funds and depositing them in a client trust account." Id. at 6. The author was a member of the Committee during the time it deliberated on and adopted N.Y. 570.
critiques N.Y. 570 as a surrogate for the minority view, contending that it is wrong as a matter of ethics, fiduciary law, and policy. Indeed, no conclusion in N.Y. 570 or any of the minority opinions is found acceptable or defensible.

Section I of this Article examines the history of the prohibition against commingling. Section II discusses the modern-day rationale for DR 9-102. Section III assesses the minority view by critiquing N.Y. 570's analysis on textual, legal, and policy grounds; considers the federal tax consequences of the issue; and points out a serious omission in N.Y. 570 which renders it inconsistent with fiduciary law. Section IV compares the Model Rules of Professional Conduct's counterpart to DR 9-102.

I. DR 9-102's Roots

The obligation to segregate client funds arises from the principle that the attorney-client relationship is one of principal and agent. As an agent, the attorney sustains any loss due to commingling of the client's property with the attorney's own property, or caused by failure to preserve the property's trust character. In the mid-nineteenth century David Hoffman, a leading American lecturer on law, published his lectures, including his highly influential Fifty Resolutions

22 The majority of bar opinions on this issue are devoid of any reasoning, merely stating results. N.Y. 570 was chosen to critique because it was the most recent opinion to give the matter significant thought and analysis. An earlier opinion by the D.C. Bar, supra note 15, also provides analysis, and the arguments advanced therein which are not replicated in N.Y. 570 are also critiqued as are arguments set forth in other bar opinions.


25 Naltner v. Dolan, 108 Ind. 500, 8 N.E. 289 (1886). In this case, two attorneys deposited client funds in a separate bank account under their firm's name and not under their client's name. No other funds were deposited to that account. The bank failed and the client sought recovery from the attorney. The general rule was that a third party was not liable for a loss of funds if the money was deposited to a separate account and its trust character preserved. Id. at 503, 8 N.E. at 290. The court, in granting recovery to the client, held that the mere creation of a separate account for a client did not preserve the trust character of the funds. Because the attorneys, as trustees, could have claimed legal title to the funds (because it was deposited in their names), the bank was required to pay the funds only to the attorneys. This would create a debtor/creditor relationship between the attorneys and the client which, in turn, would give the client a claim against the attorneys for the funds. The court concluded that for an attorney to avoid liability, he must deposit the money in a manner indicating that it is the client's money. Id. at 503-04, 8 N.E. at 291.

26 David Hoffman authored two major legal works: Legal Outlines (R.H. Helmholz & D. Bernard, Jr. eds. 1981) (1836) and A Course of Legal Study, Addressed to Students and the Profession Generally (1972) (1836). Mr. Hoffman "has contributed to elevate [the profession's] standard of learning and morals, to encourage the young aspirant for its honourable rewards, and, as a consequence, to extend its just influence in the community."
regarding professional conduct.27 One Resolution reflected and replicated the agency principle: "I will on no occasion blend with my own my client's money. If kept distinctly as his, it will be less liable to be considered as my own."28 Hoffman's Resolutions eventually formed the basis of the first formal code of ethics, adopted by the Alabama Bar Association in 1887,29 which, in turn, served as a model for the predecessor of the Code, the Canons of Ethics, adopted by the American Bar Association in 1908.30 The Hoffman admonition regarding client money became section 37 of the Alabama Code of Ethics31 and, in turn, became Canon 1132 of the Canons of Ethics, which was amended in 193333 and in 1937.34 DR 9-102 now embodies the prohibition against commingling.

II. CONTEMPORARY POLICY

Preserving the identity of client funds originally served two pur-
poses: to shield client funds from the attorney’s creditors, and to protect the attorney from liability should these funds be lost, for example, by bank failure. These original underpinnings for DR 9-102 have become relatively less important as more contemporary policies have emerged: to protect the client’s money from the attorney and the attorney from temptation. As stated in State v. Statmore, the prohibition against commingling embodied in DR 9-102 now serves the additional purpose of:

“...provid[ing] against the probability in some cases, the possibility in many cases, and the danger in all cases that such commingling will result in the loss of clients' money. Moral turpitude is not necessarily involved in the commingling of a client's money with an attorney's own money if the client's money is not endangered by such procedure and is always available to him. However, inherently there is danger in such practice for frequently unforeseen circumstances arise jeopardizing the safety of the client's funds, and as far as the client is concerned the result is the same whether his money is deliberately misappropriated by an attorney or is unintentionally lost by circumstances beyond the control of the attorney.”

Both the historical and contemporary policies are concerned with loss of client funds: the former with loss to the attorney’s creditors and the latter with loss by defalcation. Attorneys who commingle their own funds with those of their clients may confidently assume that the funds they are removing from the security account are their own when, in fact, due to inadvertence or miscalculation, they may be a client's funds. "At some point mere negligence [becomes] blatant embezzlement.” For example, if the attorney expects a large fee from settlement of a major personal injury action to arrive momentarily but lacks the cash in his office account to pay his employees, he may borrow from his clients' account to cover his present demands—fully intending of course to replace the money after he receives that large fee. Indeed, he does do so. But the situation recurs, except the fee does not materialize due to unforeseen circumstances. The attorney then borrows more money from a second client to repay the first

36 See supra note 25.
client and the pattern continues. At both junctures he has commingled funds; if client demands for repayment cannot be met, then his innocent commingling has turned into embezzlement.

By maintaining separate, clearly identifiable accounts that require accurate record keeping and reporting, the temptation to use client funds for personal use lessens, as does the potential for harm to the client. Failure to follow the requirements of DR 9-102 warrants disciplinary action even if the client suffers no harm. Because even the appearance of impropriety undermines public confidence in the legal profession, it is important to deter even relatively innocent commingling by careful maintenance of client security accounts.

III. CRITIQUE OF N.Y. 570 AND THE MINORITY POSITION

According to one court and the majority of state and city bar committees that have commented on the subject, advance payments of legal fees must be deposited to client trust accounts. A minority

40 See Comment, Attorney Misappropriation of Client Funds (pt. 2), 27 How. L.J. 1597, 1604-06 (1984) (describing case of attorney who became involved in "a process of robbing Peter to pay Paul that he hoped would end when he could catch up with a big negligence settlement or an investment killing").
41 "[L]ead us not into temptation, but deliver us from evil ... ." Matthew 6:13.
42 See Louisiana State Bar Ass'n v. Hinrichs, 486 So. 2d 116 (La. 1986) (attorney unable to remit settlement money to client because he used the money to pay personal debts).
43 Even if the client suffers no harm from the attorney's commingling, the commingling still violates DR 9-102 and is treated accordingly, although punishment may be ameliorated. See Florida Bar v. Whitlock, 426 So. 2d 955 (Fla. 1982); In re Penegor, 104 Wis. 2d 133, 310 N.W.2d 796 (1981); see also C. Wolfram, supra note 2, § 4.8, at 177 ("[I]t should normally be irrelevant that a client suffered no direct loss because of a lawyer's personal use of a trust account.").
44 See Committee on Professional Ethics & Conduct of the Iowa State Bar Ass'n v. White, 209 N.W.2d 11 (Iowa 1973); In re Windsor, 373 P.2d 612 (Or. 1962); Comment, supra note 40, at 1598 n.5.
45 Model Code, supra note 4, EC 9-5; see Comment, supra note 39, at 416 n.6.
47 See Ind. State Bar Ass'n Legal Ethics Subcomm., Formal Op. 4 (1977) (no analysis);
declares that advance fee payments may or must be deposited to the attorney's general office account, even if the funds are refundable if unearned. Since N.Y. 570 is the most thorough exposition of the minority view, it will be used as a surrogate for that view in the following critique.

N.Y. 570 expounds that advance fee payments need not be considered as "funds of clients" and therefore need not be deposited to a client trust account. The arguments the opinion poses supporting
its position are of three varieties: textual, legal, and policy.

A. Textual

The Code sections which are the subject of the textual scrutiny are DR 2-110(A)(2) and (A)(3) and DR 9-102. These sections “codify” the fiduciary nature of the lawyer-client relationship by stating protections for client property in the lawyer’s possession. The range of the protections listed is extensive, and, by distinguishing among the various forms which client property can take, the Code specializes the protections to the type of property.

The grand design of the protections enumerated can be best gleaned if the protections are listed in the chronological order in which they come to apply to client property. The birth of fiduciary concern occurs when the attorney comes into possession of client property in any of its various forms; for example, securities or funds. At that point, if it did not come directly from the client he is to notify the client of its receipt. The attorney must also initiate careful record keeping procedures for all client property in his possession regardless of whether it came to him directly from the client or was paid or delivered by a third party, and is to render an accounting to the client whenever appropriate. If the property is in the form of securities or other valuable items, it is to be safeguarded by placement in a safe deposit box (or other safe place) as quickly as possible. If the property is in the form of “funds of clients paid to a lawyer” including “[funds belonging in part to a client and in part presently or potentially to the lawyer,” it is to be safeguarded by segregating it from the lawyer’s personal funds and depositing it to a client security than the attorney. Some portion of these funds may undoubtedly be used to satisfy the lawyer’s fee. Typically, these funds are properties of the client received from the sale of assets or settlement of a claim or estate and held temporarily by the attorney where the temptation for the attorney to use or confuse the client’s assets with his own must be avoided. Hence, the detailed requirements for segregating and safeguarding these properties.

D.C. Bar, supra note 15, at 4-5. Although advance fee payments are received directly from the client rather than a third party, the temptation to commingle or misappropriate the funds is still very strong. See supra notes 37-40 and accompanying text. Because D.C. opines that this kind of temptation necessitates the Code’s strict accounting and record keeping requirements for monies received from third parties, these requirements should also apply to advance fee payments. See D.C. Bar, supra note 15, at 7 (dissent) (“If the Code prohibits commingling of traditional trust funds in order to avoid these dangers, it is reasonable to conclude that the Code also prohibits commingling of advances in order to avoid an identical danger.”).
If the lawyer seeks to withdraw from representation—whether at his initiation or that of the client—he must first return all client property in his possession, including not only the various forms of property already mentioned but also "papers" which, though they may not have intrinsic value, are necessary if the client is to pursue or defend his claim with another lawyer. After withdrawal, and without the need for a client request, the lawyer is to refund promptly any unearned advance fee payments. When the advance fee was initially paid, it was in the form of "funds of clients paid to a lawyer" (and therefore to have been deposited into a security account). Assuming that as of the time of withdrawal some or all of the work contemplated has been completed, then the advance fee exists as "[f]unds belonging in part to a client and in part . . . to the lawyer" (to which the depository requirement extends though the lawyer can withdraw undisputed amounts due him). Finally, all client property in the lawyer's possession is to be promptly paid or delivered to the client on request, providing that the client is entitled to the property.

N.Y. 570 presents four textual arguments to advance the idea that "funds of clients" do not include advance fee payments:

1. Textually, it appears that the drafters of the Code of Professional Responsibility did not consider advance payments of fees to be client funds necessitating their deposit in a trust account. DR 9-102(A) makes no explicit reference to advance fee payments. The Code does make explicit reference to advance fee payments in DR 2-110(A)(3), which requires that any unearned fee advance be promptly refunded upon termination of the representation; it does not require that the advance be deposited in a trust account until earned. Indeed, DR 2-110 treats fee advances and client property as different things. It provides specifically in DR 2-110(A)(2) for the return of all client property to the client upon withdrawal from employment, and then provides separately for the refund of any unearned fee advance in DR 2-110(A)(3).

2. Nor is there any suggestion in any of the Code's numerous provisions dealing with legal fees or client funds that advance payments of legal fees are deemed client funds to be deposited in a trust account.

N.Y. 570, supra note 21, at 4.

The sequence in which the four textual arguments appear in N.Y. 570 is 3, 1, 2, 4. The third argument of N.Y. 570 is listed and discussed first because it benefits the flow of the discussion.
ent property and advance fee payments are different things, that is, advance fee payments are not a subset of client property, and since funds of clients are a subset of client property, then advance fee payments cannot therefore be included in funds of clients;\textsuperscript{63} (2) there is no indication in the text in which funds of clients appears (DR 9-102(A)) that funds of clients include advance fee payments; therefore, funds of clients do not include advance fee payments; (3) there is no indication in the text in which advance fee payments appears (DR 2-110(A)(3)) that they are included in funds of clients; therefore, funds of clients do not include advance fee payments; (4) in the rest of the Code, there is no indication that funds of clients include advance fee payments; therefore funds of clients do not include advance fee payments.

1. Client Property and Advance Fee Payments Are Different Things

The textual argument advanced by N.Y. 570 to be discussed first is that "DR 2-110 treats fee advances and client property as different things."\textsuperscript{64} DR 2-110(A)(2) provides for the return of client property before withdrawal,\textsuperscript{65} and DR 2-110(A)(3) provides for the return of advance fees upon withdrawal.\textsuperscript{66} Because these Code sections treat fee advances and client property as different things, the authors of N.Y. 570 argue that advance fees are not a part of client property. Further, since funds of clients are included in client property, then fee advances cannot be included in funds of clients.\textsuperscript{67}

Both the premise and the logic of this argument are wrong. By addressing advance fee payments and other client property in different subsections, the drafters of the Code have not evinced an intent to declare them "different things." There are several reasons why advance fee payments are singled out for specific attention—none of which reflect an intent to classify advance fee payments to the extent unearned as other than client property. Indeed the intent is to the

\textsuperscript{63} The argument that appears in N.Y. 570 is that client property and advance fee payments are treated "as different things" in DR 2-110. The conclusion that therefore advance fee payments cannot be included in funds of clients is not expressly stated but can be inferred. Indeed, not inferring the conclusion in the form stated could lead to a nonsequitur, i.e., since advance fee payments are, according to N.Y. 570, different from client property, then they are not "funds of clients."

\textsuperscript{64} N.Y. 570, supra note 21, at 4.

\textsuperscript{65} Model Code, supra note 4, DR 2-110(A)(2).

\textsuperscript{66} Id. DR 2-110(A)(3).

\textsuperscript{67} Although N.Y. 570 does not explicitly conclude that because fee advances are not client property, therefore they are not "funds of clients," that is the inference (indeed the only inference) that logically flows from the N.Y. 570 analysis.
contrary. DR 2-110 sets forth conditions for withdrawal from employment, including the steps a withdrawing lawyer must take “to avoid foreseeable prejudice to the rights of his client.” Before the lawyer withdraws, he must return the client’s property, especially the papers which the client will need if he is to continue representation with another lawyer. As for advance fee payments, any unearned portion need not be refunded in advance since, as a practical matter, the amount to be refunded can only be calculated after withdrawal. Indeed, the act of withdrawal, which may include petitioning a tribunal for permission to withdraw or meeting with the client’s replacement lawyer to bring him up to speed, may itself result in billable hours; the necessary accounting, therefore, can only take place subsequent to withdrawal. Therefore, repayment of unearned advance fees could not have been addressed in DR 2-110(A)(2) because of the temporal differences. From this perspective, DR 2-110(A)(3) is improperly paragraphed; it should have appeared as a subset of DR 2-110(A)(2)—as DR 2-110(A)(2)(a) rather than as DR 2-110(A)(3).

Advance fee payments are also singled out for attention because of the need to articulate the substantive position that advance fee payments are not the lawyer’s money until earned. This is made a part of the “withdrawal” provisions of the Code because it is in the context of withdrawal that the issue of refundability is most germane. DR 2-110(A)(2) commands the return of all property “to which the client is entitled”; DR 2-110(A)(3) defines that entitlement to include advance fee payments to the extent unearned—again demonstrating that DR 2-110(A)(3) is a subset of DR 2-110(A)(2). The substantive statement is a part of a broader common law rule recognized by a majority of states that discharged attorneys—who must withdraw if they are discharged with or without cause—may recover only the reasonable value of the services they have rendered and are not entitled to contract damages.

68 Model Code, supra note 4, DR 2-110.
69 Id. DR 2-110(A)(2).
70 Id. DR 2-110(A)(1).
71 Consider the situation where a client turns over money to an attorney to be used to buy a house. Clearly, that money is the client’s, see Peterson, Trust Accounts and Client Property, 49 Tex. B.J. 366, 366 (1986), and is included in DR 2-110(A)(2) as property that must be returned prior to the attorney’s withdrawal. Since both the real estate deposit and the unearned advance fee payments are client’s money, what does DR 2-110(A)(3) add to DR 2-110(A)(2)? DR 2-110(A)(3) clarifies that advance fee payments are not the attorney’s money until earned.
72 Model Code, supra note 4, DR 2-110(B)(4).
73 See Note, For a Few Dollars More: Client’s Right to Discharge His Attorney Under a Contingent Fee Contract, 7 Cardozo L. Rev. 913, 919 n.40 (1986) (citing cases from 34 states).
As demonstrated, expressly dealing with advance fee payments to the extent unearned in one subsection of the Code is not a basis for concluding that they are not a form of client property. Indeed, it is the specialized treatment accorded the advance fee payment that specifically categorizes it as a form of client property.

Even accepting N.Y. 570's faulty premise—since advance fee payments and client property are different things, then advance fee payments are not a part of client property—the conclusion derived—since funds of clients is included in client property, then advance fee payments cannot be included in funds of clients—is illogical. As illustrated below, both advance fee payments and funds of clients can be wholly included in client property even if they are regarded as mutually exclusive. By the same token, however, it does not logically follow that because unearned advance fee payments are a form of client property, that therefore they are "funds of clients." That is, though funds of clients and advance fee payments are both included in client property, it does not follow that advance fee payments are included in funds of clients (or that funds of clients is included in advance fee payments). That must be separately established as a matter of statutory construction (and will be established following the discussion of N.Y. 570's second and third arguments).

2. DR 9-102(A) Does Not Indicate that "Funds of Clients" Include Advance Fee Payments

Since the strategy for any textual argument is dictated by what the text says (and does not say), and since there is no Code text stating that advance fee payments are not included in "funds of clients," then a less persuasive but next best alternative is to argue, as does N.Y. 570 in the second of its four arguments, that DR 9-102(A)'s depository requirements which are applied to "funds of clients" does not apply to advance fee payments because if the drafters of the Code
had so intended, they would have so stated. That is, since the Code
does not specifically define "funds of clients" to include advance fee
payments, then advance fee payments are not funds of clients. But
it is just as persuasive to argue, as a matter of logic, that because the
drafters of the Code did not say elsewhere that "funds of clients" do
not include funds which are in the form of advance fee payments, and
since the term "funds of clients" can easily be interpreted to include
advance fee payments (as a majority of opining bar associations have
so found), then if the intent was not to include advance fee pay­
ments, the drafters would have so stated. Therefore, "funds of cli­
ents" do include advance fee payments. Logically, then, both the
N.Y. 570 argument and its converse fail.

This is not to say, however, that textual arguments regarding
whether "funds of clients" include advance fee payments are not
available. While the omission of an inclusion does not in and of itself
yield meaning, other textual material can provide persuasive argu­
ment. Note that DR 9-102(A) provides that all "funds of clients" are
to be deposited to a security account except funds which are "ad­
vances for costs and expenses." By stipulating that certain specific
"advances" need not be deposited to a security account, and by recog­
nizing the existence of a "fee paid in advance" in DR 2-110(A)(3) but
not including that advance in the advances listed as exceptions in DR
9-102(A), the drafters could be indicating that advance fees had to be
deposited to a security account. For the position taken by N.Y. 570
to be persuasive, the drafters would have to have said that "funds of
clients" except "advances for costs ... expenses [and fees]" were to be
deposited to a security account. If omission of the exception for fees
in the listing of exceptions to the depositing requirement is pur­
poseful, then the position taken by N.Y. 570 is against the drafter's
meaning.

3. DR 2-110(A)(3) Does Not Indicate that Client Funds Include
Advance Fee Payments

The third textual argument is the mirror image of the second:

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74 Cf. D.C. Bar, supra note 15, at 5-6 (same argument applied to D.C. Code of Professional Responsibility).
75 This is a parody of the ejusdem generis rule of construction, where specific words follow­
ing general words are interpreted to limit the meaning of the general words. Black's Law
Dictionary 464 (5th ed. 1979). In this case, the argument is that general words which are not
followed by specific words are limited by the absence of the specific words.
76 See supra note 47. But see N.Y. 570, supra note 21, at 4, which argues that "it strains
the normal meaning of words to interpret the phrase 'funds of clients' as embracing advance
legal fees paid to the lawyer."
77 Model Code, supra note 4, DR 9-102(A).
namely, that advance fee payments are not included in funds of clients because the text in which advance fee payments appear does not say they are included in funds of clients. Thus, N.Y. 570 argues that since DR2-110(A)(3) commands only that a lawyer promptly refund an unearned advance fee after withdrawal, and does not state where the lawyer must keep these funds prior to withdrawal, they need not be kept in a security account. That argument is tautological, however, in that its validity depends upon assuming the conclusion that it seeks to draw; namely, that DR 9-102(A)’s “funds of clients” do not include advance fee payments. If one concluded that “funds of clients” include advance fee payments, then of course the reason why DR 2-110(A)(3) does not expressly provide for the deposit of advance fees into a security account is because that it is provided for in DR 9-102(A).

Contrary to the position of N.Y. 570, there is considerable textual evidence—supplemented by legal and policy considerations—that advance fee payments to the extent unearned are “funds of clients,” and that the “grand design” set forth at the beginning of this section is the one most consistent with the interaction of the various provisions of DR 2-110 and DR 9-102.

Both DR 9-102(B)(3) and DR 9-102(A) deal with client funds; in the former, the phraseology is “funds . . . of a client,” and in the latter, “funds of clients.” The terms must be taken as identical in meaning. Therefore, if advance fee payments are not “funds of clients” for purposes of DR 9-102(A), then they are not “funds . . . of a client” for purposes of DR 9-102(B)(3), which provides that a lawyer shall maintain “complete records” and “render appropriate accounts” of client funds in “the possession of the lawyer.” If N.Y. 570’s conclusions were controlling, then a lawyer receiving an advance fee payment who is discharged prior to completion of the work for which he was hired, and who therefore is obligated to return the unearned portion of the advance fee, would not be obligated to have kept records of the funds or to render an accounting to the client.

DR 9-102(B)(4) provides for the prompt return to the client, on his request, of all “funds, securities, or other properties in the possession of the lawyer which the client is entitled to receive.” Again, the

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76 N.Y. 570, supra note 21, at 4.
77 See infra notes 101-27 and accompanying text.
80 Model Code, supra note 4, DR 9-102(B)(3).
81 Cf. Va. State Bar, supra note 47 (lawyer who receives an advance fee and whose client discharges him before the services are fully performed must account to the client, upon request, for all or any part of the fee paid and services performed).
82 Model Code, supra note 4, DR 9-102(B)(4).
"funds" of DR 9-102(B)(4) are the "funds" of DR 9-102(A). Assume that very shortly after payment of a fee advanced for the performance of a specific service, a client has a change of heart and decides not to proceed with that legal matter. The lawyer, to that point, has expended no time. Under the leading case of Martin v. Camp, the lawyer is obligated to return the entire advance fee. Since the lawyer has not withdrawn (because the client is still contemplating going forward), he is not obligated by DR 2-110(A)(3) to return the advance fee. Nor would DR 9-102 provide the basis for the lawyer's obligation to refund the funds, as requested, if, as N.Y. 570 stated, "funds of clients" did not include advance fee payments. Indeed, once DR 9-102 is read as N.Y. 570 reads it, there is no basis in the Code (or Model Rules) to conclude that the lawyer is obligated to promptly return the fee upon request. The N.Y. 570 interpretation of DR 9-102(B)(4) is therefore inconsistent with the all-inclusive compass of that section regarding the prompt payment of all client funds in the lawyer's possession which the client is entitled to receive.

DR 9-102(A)(2) states that "[f]unds belonging in part to a client and in part presently or potentially to the lawyer ... must be deposited" to a trust account. Two situations are envisioned by that requirement: (1) where payment is received in a contingent fee case from which a percentage is to be paid to the lawyer; and (2) the advance fee payment. When the fee payment is advanced to the lawyer, he has not yet earned that money; the money is only potentially his. DR 9-102(A)(2) further provides that the portion of the jointly owned funds belonging to the lawyer may be withdrawn "when due" (unless the client disputes the payment), again specifically contemplating the advance fee payment situation (as well as the contingent fee). As the lawyer performs the requested service, he can withdraw that part of the advance fee that he has earned from the trust fund. N.Y. 570 advances no credible argument why such jointly owned funds should not be interpreted according to their plain meaning to include ad-

84 Model Code, supra note 4, DR 9-102(A)(2).
85 "By speaking of funds which 'potentially' belong to the lawyer, this provision appears to anticipate the [advance fee situation] ... At the time the advance is tendered by the client, the lawyer has not yet earned it, and the money is only potentially his ..." D.C. Bar, supra note 15, at 6 (dissent). See Shank, supra note 47, at 371; see also State Bar of Tex., supra note 9, at 12 (if "no guarantee that the attorney will be entitled to the full amount," the funds must be deposited into a trust account).
86 Model Code, supra note 4, DR 9-102(A)(2).
87 See Miele v. Commissioner, 72 T.C. 284, 286 (1979) (earned fees withdrawn quarterly for convenience).
88 Those inclined to pick at nits could take issue with the "plain meaning" argument. An
advance fee payments. 89

N.Y. 570's argument that "funds of clients" do not include advance fee payments because the Code does not specifically provide either in DR 2-110(A)(3) or DR 9-102(A) that they do has already been dealt with as a matter of logic. 90 From the perspective of meshing the two Code sections in the manner most consistent with the stated purposes and objectives, we can see obvious reasons why DR 2-110(A)(3) does not expressly state that advance fee payments are to be deposited to a trust account. The Code's drafters did not spell out the entire panoply of protections accorded client property in DR 2-110 because property was being considered only in the context of withdrawal from representation. Providing in DR 2-110 that advance fee payments were to be deposited to a security account not only would be irrelevant to DR 2-110's purpose, but would also be redundant since DR 9-102, as per its title, "Preserving Identity of Funds and Property of a Client," provides protections regardless of whether the lawyer's representation is ongoing or terminating. DR 2-110(A) also does not require the withdrawing lawyer to provide the client with an accounting of his property or advance fee payment though that is germane to withdrawal, since that is provided for in all circumstances in DR 9-102(B)(3). Similarly, it does not provide for deposit of property (to the extent that funds are involved) or advance fee payments into a security account because that is provided for in all circumstances in DR 9-102(A).

The schematic design of DR 9-102 further supports the thesis of this paper. Client property must be safeguarded—that is the fiduciary ukase. But how? "Funds of clients" are to be deposited into a security account to protect them from the lawyer's creditors, 91 from the advance fee paid to a lawyer, which both he and the client anticipate the lawyer will earn in toto, could be said to be not "[f]unds belonging in part of a client and in part presently or potentially to the lawyer," Model Code, supra note 4, DR 9-102(A)(2), but rather, funds potentially belonging in whole to the lawyer. The same situation occurs when a lawyer on a one-third contingent fee receives a settlement check in a personal injury case made out jointly to his client and himself, which he deposits to the trust account, and then pays out two-thirds to the client but does not withdraw his one-third because the client disputes the contingent fee; the funds remaining are potentially entirely the lawyer's. To state precisely what the drafters meant, DR 9-102(A)(2) should be read as if it said "[f]unds belonging in part [or in whole, presently or potentially] to a client and in part [or in whole] presently or potentially to the lawyer . . . must be deposited" to the security account. The solution to this nit does not diminish the textual argument regarding DR 9-102(A)(2).

89 It is secondarily applicable to the contingent fee case where the client objects to the fee percentage. That objection suspends the lawyer's right to withdraw the part that represents his fee until the dispute is resolved. Model Code, supra note 4, DR 9-102(A)(2).

90 See supra notes 75-78 and accompanying text.

91 See supra note 35.
lawyer,\(^92\) and from the lawyer's self-help remedy if those funds include or constitute the lawyer's fee. DR 9-102(A)'s depository requirements do not deal with the broader category of client property, because items which are client property but not "funds of clients," such as client papers, deeds, and securities, are physically incapable of being deposited into a security account. They can and must be safeguarded by deposit into a safe deposit box,\(^93\) which is the closest equivalent of deposit to a security account. As already noted, the notification, record keeping, accounting, and payment requirements apply to all client property in the lawyer's possession. "Funds of clients" and other client property require different treatment with regard to their safeguarding—the former in security accounts, and the latter in a safe deposit box—but are treated alike, since funds are a subset of property, regarding notification, record keeping, accounting, and repayment. Accordingly, the "failure" to include in DR 9-102(A) that "funds of clients" include advance fee payments or to include in DR 2-110(A)(3) that advance fee payments are "funds of clients" are not failures at all, but simply reflect a drafting design which both from the point of view of specific Code provisions and the broader fiduciary purposes of the Code, is most consistent with the position that "funds of clients" include advance fee payments.

4. Code Gives No Indication that Client Funds Include Advance Fee Payments

The fourth textual argument raised by N.Y. 570 is that there is no "suggestion in any of the Code's numerous provisions dealing with legal fees or client funds that advance fee payments are to be deposited in a trust account."\(^94\) However, eight of the nine Disciplinary Rules and thirteen of the fourteen Ethical Considerations cited\(^95\) are totally irrelevant\(^96\) to the question of whether advance fee payments are "funds of clients." For example, DR 2-106 sets forth the criteria for determining whether a fee is excessive,\(^97\) DR 2-107 deals with for-

\(^{92}\) See supra text accompanying note 38.

\(^{93}\) Model Code, supra note 4, DR 9-102(B)(2).

\(^{94}\) N.Y. 570, supra note 21, at 4.

\(^{95}\) Model Code, supra note 4, DR 2-103(C)-(D), 2-106, 2-107, 2-110(A)(3), 3-102, 4-101(C)(4), 5-103(A), 5-106(A); EC 2-8, 2-15 to -25, 2-32, 9-5.

\(^{96}\) DR 2-110(A)(3) which is cited is relevant and has been dealt with extensively in this section. EC 9-5 is also cited and is also relevant, but simply states that "[s]eparation of the funds of a client from those of his lawyer not only serves to protect the client but also avoids even the appearance of impropriety, and therefore commingling of funds should be avoided." Model Code, supra note 4, EC 9-5.

\(^{97}\) Id. DR 2-106.
warding fees, DR 3-102 with dividing fees with a non-lawyer, and DR 4-101(C)(4) with a lawyer’s revealing confidences or secrets to collect his fee. Neither these nor the other sections cited have any bearing on the issue in question.

**B. The Legal Argument of Ownership**

N.Y. 570 argues that, as a matter of law, advance fee payments become the property of the lawyer upon receipt, and therefore “it strains the normal meaning of words to interpret the phrase ‘funds of clients’ as embracing advance legal fees paid to the lawyer.” The argument based on legal ownership proceeds:

Normally, when one pays in advance for services to be rendered or property to be delivered, ownership of the funds passes upon payment, absent an express agreement that the payment be held in trust or escrow, and notwithstanding the payee’s obligation to perform or to refund the payment.

The operative word in the quoted sentence is “normally.” The lawyer-client relationship is not a normal, arm’s length business transaction—it is a fiduciary relationship based on trust and loyalty. A lawyer who is legally entitled to his contractually provided fee under commercial law standards may not be entitled to the fee as a matter of fiduciary law. Whereas a homeowner who dismisses a painter without just cause in the middle of a job is liable for breach of contract damages, a client who discharges his lawyer arbitrarily is not liable for contract damages, but only for the value of the services actually

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98 Id. DR 2-107.
99 Id. DR 3-102.
100 Id. DR 4-101(C)(4).
101 N.Y. 570, supra note 21, at 4.
102 Id. at 4-5. See also D.C. Bar, supra note 15, at 3 (“Prepayments are commonly made for many other types of goods and services.”).
103 [A] lawyer’s duty is a high one which, because of the nature of the relationship that exists between an attorney and his client, embraces moral standards that are more stringent than those applicable to others. This duty, which is first assumed with the taking of the oath on admission to the bar, is not shed as long as one remains a member of the profession.
105 A lawyer “cannot rely on the commercial laws to collect a fee that he has not entirely
rendered. To seek to equate the lawyer-client relationship to the normal business relationship is to ignore the thrust of the Code of Professional Responsibility, which states that it is the "obligation of lawyers . . . to maintain the highest standards of ethical conduct." Further, it ignores the specific safeguards set forth in the Code to preserve and protect client funds, by maintenance of records, safekeeping, prompt refund, and deposit into a security account.

The attorney also does not possess sole ownership of the advance fee payment upon receipt because the attorney must return any unearned fees; the client thus retains a continuing interest in these funds. Since fees are not earned until services are rendered, attorneys hold the advance fee payments in trust for the client until the services are performed and the fees are thereby earned. These funds are therefore "funds of clients" within the meaning of DR 9-102(A), and under its terms must be deposited into a client trust account.

C. Policy Considerations

Policy considerations strongly support the position that the depository requirements for "funds of clients" apply to advance fee payments. Three distinct policy goals may be identified: (1) to preserve the client's property from the reach of the lawyer's creditors; (2) to preserve the client's property from possible misappropriation by the lawyer; and (3) to enable the client to realistically dispute a fee where the funds are already in the lawyer's possession by disallowing a self-help resolution by the lawyer and instead preserving the disputed funds intact until the dispute is resolved.

The first policy goal is best effectuated by depositing the advance fee payment into a trust account. If a part of the advance fee has to be earned, due to his discharge by his client . . . The contract provision concerning compensation is therefore unenforceable." Simon, 383 So. 2d at 1324.

107 Model Code, supra note 4, Preamble.
108 Id. DR 2-110(A)(3)-(A)(4); DR 9-102.
110 Martin, 219 N.Y. at 176, 114 N.E. at 48; N.Y. 570, supra note 21, at 1 n.1.
112 See Model Code, supra note 4, DR 9-102(A).
113 See supra note 35.
114 See supra text accompanying note 38.
115 Model Code, supra note 4, DR 9-102(A)(2).
returned to the client, either because of termination or completion of services, it may no longer be available for return if deposited to the attorney's personal account and attached by the attorney's creditors. If deposited to a security account, the funds are insulated from the reach of creditors.

The prophylactic policy goal of reducing the likelihood that client funds will be misappropriated by the lawyer if commingled rather than deposited to a security account has been previously addressed. The importance of this policy consideration is accentuated by empirical data on the causes of lawyer defalcation. In New York, the failure to return unearned fee advances constitutes a major disciplinary problem. The Clients' Security Fund of New York (the "Fund"), which has been set up to compensate clients who have been defrauded by their lawyers, pays out a substantial percentage of its claims to compensate "clients who paid legal fees in advance to attorneys who later abandoned them without completing the services they agreed to provide." Since the Fund's shortage of resources permits it to reimburse clients for only a small percentage of each legitimate claim filed, a requirement that advance fees be deposited to a security account would not only reduce the misappropriation of client funds but would also increase the percentage of each supportable claim that could be repaid. The position advocated by N.Y. 570 would tend to increase misappropriation of client funds, decreasing the amount of each claim that a defrauded client could receive from the Fund.

The third policy goal is to protect a client's right to dispute a fee—where the funds are in the attorney's possession—by prohibiting

116 Id. DR 2-110(A)(3); Model Rules, supra note 4, Rule 1.5 comment.
117 Model Code, supra note 4, DR 9-102(B)(4).
118 See supra text accompanying notes 23-36.
119 See supra text accompanying notes 37-46.
121 Letter to Professor Brickman, supra note 120.
122 Periodic audits would increase the efficacy of the requirement. See supra note 46.
123 A nonscientific survey by the author indicated that most attorneys deposit advance fee payments to their personal accounts. Indeed, attorneys were surprised to learn that there was even an issue regarding the propriety of that deposit. This may account for why such a high percentage of claims paid by the Fund is for advance fees paid to lawyers who do not complete the work for which they were retained.
the attorney from withdrawing the funds representing his fee from the security account until the dispute is resolved.\textsuperscript{124} N.Y. 570 speaks directly to this goal:

The very reason that many lawyers require advance fee payments in the first place is so that they will not be subject to a client's refusal to pay for legal services after they are rendered. If fee advances were required to be deposited in a client trust account, it would follow that this purpose of requiring advance payment could be easily defeated by a client who, after services are rendered, disputes a justly earned fee. Under DR 9-102(A)(2), the disputed portion of the fee would have to be retained in the client trust account, and would not be available to the lawyer, until the dispute was resolved.\textsuperscript{125}

Precisely. The trust requirement imposed by DR 9-102(A) frustrates an underlying purpose of the advance fee: to weight the financial relationship between lawyer and client in favor of the lawyer.\textsuperscript{126} DR 9-102(A), in effectuating the fiduciary nature of the relationship, places the interests of the client paramount. The burden is on the attorney to resolve a fee dispute since he cannot withdraw the funds until the dispute is resolved. The implicit message of N.Y. 570 is that to avoid this protection afforded the client, lawyers should obtain advance fee payments and deposit them to their general accounts. Thus, the burden in any fee dispute would be shifted to the client. The policy of N.Y. 570 is the diametric of the fiduciary policy articulated in DR 9-102 (and repeated with even greater emphasis in the Model Rules).\textsuperscript{127}

Similar to N.Y. 570's policy position is the District of Columbia Bar's argument that the additional accounting burdens and costs incurred by attorneys if advance payments must be deposited to client trust accounts favor the placement of these fees in the attorney's office account.\textsuperscript{128} DR 9-102(B)(3) requires detailed record keeping for all "funds, securities, or other properties" of the client received by the attorney.\textsuperscript{129} Further, the District of Columbia bar argues that interest

\textsuperscript{124} Model Code, supra note 4, DR 9-102(A)(2).
\textsuperscript{125} N.Y. 570, supra note 21, at 5 (footnote omitted). Cf. D.C. Bar, supra note 15, at 2-3 ("Typically, lawyers seek fee advances when dealing with clients where no established relationship exists, where a client's past behavior raises concern about promptness of future payment or where substantial legal work will occur at the outset.").
\textsuperscript{126} D.C. Bar, supra note 15, at 6-7 (The objective of the fee advance is to "take the attorney away from the financial mercies of the client.").
\textsuperscript{127} "[A] lawyer may not hold funds to coerce a client into accepting the lawyer's [fee] contention. The disputed portion of the funds should be kept in trust..." Model Rules, supra note 4, Rule 1.15 comment.
\textsuperscript{128} See D.C. Bar, supra note 15, at 7-8.
\textsuperscript{129} Model Code, supra note 4, DR 9-102(B)(3). The Fund recommended that the courts
earned on these trust accounts also creates "burdensome accounting problems" which the minority contend will cause exasperated attorneys and clients "to place the funds in non-interest bearing accounts, benefitting only the bank." However, the practice of depositing advanced fees into the 9-102 trust account and . . . self-restraint as to the use of fees until they are earned would not impose significant burdens upon attorneys in light of DR 9-102(A)(2) which provides that those portions of funds so deposited may be withdrawn by the attorney when due unless the right to receive those funds is disputed by the client. The only real burden imposed upon the attorney in such a case involves some additional bookkeeping. . . . [A]dditional bookkeeping is a necessary burden of the profession. In light of the harm to the profession and the public caused by the loss of clients' funds and by the mere appearance of impropriety, it is a relatively small burden for the profession to bear.

In addition to bookkeeping burdens, the minority position argues that the existence of clients' security funds supports their view—an argument akin to condoning bank robbery because banks are insured.

D. Tax Consequences

Although N.Y. 570's authors declined to consider the tax consequences of their decision, the different tax treatments under the ma-


130 D.C. Bar, supra note 15, at 7.

131 Id. at 8. In today's world of computerized bookkeeping, allocating interest among the various client moneys in a security account presents little difficulty. Moreover, the issue will only be significant if large sums are involved. In that circumstance, there should be a clear understanding with the client as to who is entitled to the interest generated.


133 Clients' security funds have been established in many jurisdictions to compensate aggrieved clients for the dishonest actions of their lawyers. The funds were created "to promote public confidence in the administration of justice and the integrity of the legal profession by reimbursing losses caused by the dishonest conduct of attorneys . . . ." 1986 Annual Report, supra note 120, at 4. See generally Comment, supra note 39, at 424-32 (goals of fund).

134 See D.C. Bar, supra note 15, at 7. Since these funds will partially compensate the victimized client, the minority is satisfied that these funds will make amends for a dishonest lawyer's behavior or the inconvenience to the client of having to pursue fee reimbursement in court. Since 1982, however, New York's Clients' Security Fund has only reimbursed 986 claimants out of 1500 processed claims. The disbursements totalled $3,957,544, but the losses exceeded $7,000,000. 1986 Annual Report, supra note 120, at 1. Further, because attorneys are fiduciaries, see supra note 1 and accompanying text, clients should not have to pursue their attorneys in court for the return of unearned fees. Thus, the minority's reliance on clients' security funds is misplaced.

135 N.Y. 570, supra note 21, at 7 n.6.
majority and minority positions justify such consideration. If deposited to a trust account, advance fee payments are not income for federal tax purposes until undisputedly earned; but if deposited to an attorney's account, the advances are income immediately. The Tax Court reached this conclusion in Miele v. Commissioner, determining that "whether the law firm was in receipt of income when the prepaid legal fees were received by it... depend[ed] upon whether the firm received the fees under a claim of right and without restriction as to their disposition." By analyzing the requirements of the Pennsylvania Code of Professional Responsibility section governing client funds and property, the court concluded that under Pennsylvania law governing attorneys, "prepaid legal fees received by the firm are to be treated as owned by the client until an undisputed amount is due the firm." The court next reasoned that "the prohibition against commingling these funds with the law firm's and restrictions upon use until an undisputed amount is due clearly indicate the firm did not receive these funds under a claim of right and without substantial restriction as to disposition." Consequently, advance payments of legal fees are not income when actually received, but when undisputedly earned.

Thus, by stating that prepaid legal fees are not client funds that require placement in a trust account unless there is an agreement by the lawyer and client to the contrary, the New York State Bar Association Committee on Professional Ethics has effectively required that New York attorneys treat advance fee payments as income upon receipt. Therefore, if the client exercises his right to terminate the relationship before the fee is earned, and that occurs in the tax year following receipt, tax liabilities would be generated that could not be

136 Miele v. Commissioner, 72 T.C. 284 (1979). In Miele, a Pennsylvania law firm (taxpayer) followed the majority position and deposited all advance payments for legal fees in client trust accounts. Id. at 285.
137 Id. at 284.
138 Id. at 289 (citing North Am. Oil Consol. v. Burnet, 286 U.S. 417, 424 (1932)).
139 Id. at 289-90. That section, Pennsylvania Code of Professional Responsibility Disciplinary Rule 9-102, is textually identical to Model Code, supra note 4, DR 9-102.
140 Miele, 72 T.C. at 290.
141 Id.
142 The Miele court also held that advance fee payments are "constructively received" when earned even if the funds are not removed from the trust account. Id. at 290-91.
143 N.Y. 570 opines that advance fee payments are the attorney's property when received, but it permits the attorney and client to contract that the prepayment is the client's property. N.Y. 570, supra note 21, at 6-7. If the attorney and client do agree that the advance fee is the client's property and therefore, under DR 9-102, must be deposited to a client trust account, the advance fee would not be treated as income until undisputedly earned by the attorney. This agreement is effective for tax purposes even though the attorney's sole motivation for entering it is for tax deferral purposes. See Gregory v. Helvering, 293 U.S. 465, 469 (1935).
offset until the next year. The majority position, of course, avoids this inconvenience for the lawyer.

E. **N.Y. 570 and Fiduciary Law**

Whether an advance fee payment is to be deposited to a security account or to a personal account has been determined by all of the commenting bar associations, except N.Y. 570, to be a binary decision. It must go into one or the other. If the advance fee is not "funds of clients" but rather the attorney's money, then a supercautious lawyer seeking to be scrupulous would be guilty of commingling if he deposited the advance fee to his trust account. To avoid this either/or situation and presumably to give the lawyer control over his income flow for federal tax purposes, N.Y. 570 essentially gives the lawyer the option. The advance fee is not "funds of clients" unless the lawyer entered into an agreement with the client "to treat the advance payments or legal fees as client funds and deposit them in a client trust account."144 The client willing to pay an advance fee to retain the lawyer—without designating the sum as "funds of clients" for purposes of DR 9-102(A)—will of course be willing to agree, at the lawyer's request, that they be denominated as "funds of clients" if that suits the lawyer.

This "best of both worlds" approach to advance fees omits an important element. Since the lawyer is a fiduciary for the client,145 and since the client typically does not comprehend the significance of the "funds of clients" designation, which is for the benefit of the lawyer at the client's expense, it is the fiduciary duty of the lawyer, in presenting the retainer agreement, to explain to the client the significance of the distinction.146 Specifically, the client would have to be told that if he agreed to designate the funds as the lawyer's own, then he would be forfeiting the protection afforded him by DR 9-102(A)(2)

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144 N.Y. 570, supra note 21, at 2.
146 Model Code, supra note 4, EC 5-7, 7-8, 2-20; Florida Bar v. Moriber, 314 So. 2d 145, 146-49 (Fla. 1975); Robinson v. Sharp, 201 Ill. 86, 66 N.E. 299 (1903); Moran v. Simpson, 42 N.D. 575, 173 N.W. 769 (1919); 2 E. Thornton, A Treatise on Attorneys at Law § 429, at 743 (1914) ("Attorneys, in entering into contracts of employment with clients, are required to exercise the highest order of good faith . . . disclosing all information . . . as to facts which would or might influence him either in entering into, or refusing to execute, the contract."); N.Y. State Bar, Op. 569 (1985); N.Y. County Lawyers' Ass'n Comm. on Professional Ethics, Op. 371 (1945); cf. Klein v. First Edina Nat'l Bank, 293 Minn. 481, 481, 196 N.W.2d 619, 622 (1972) (per curiam) (where bank knows customer is placing trust and confidence in it, bank has special duty to counsel and inform customer of all material facts, including bank's motives).
with regard to disputing the fee. Further, fiduciary law would require that the now fully informed client be given the option of designating the funds as "funds of clients" or the lawyer's own. A client who "willingly" exercises his option to designate the funds as the lawyer's own is almost certainly uninformed.

Therefore, even if the New York State Bar Association Committee on Professional Ethics elects to retain N.Y. 570, it is bound to rectify its incomplete opinion by addition of the fiduciary requirements enumerated above.

IV. THE MODEL RULES COMPARED

In 1983, the American Bar Association replaced the Code with the Model Rules of Professional Conduct ("Rules"). Although New York has rejected the Rules, an examination of the Rules with regard to advance fee payments is relevant and confirms the conclusion that both under the Model Rules and Model Code, advance fee payments are to be deposited to a trust account. In form, the Rules follow a "Restatement of the Law" format. Research notes follow each new rule, comparing that rule with its counterpart in the Code.


148 Arguably, failure to do so would violate DR 1-102(A)(2) which prohibits a lawyer from "circumvent[ing] a Disciplinary Rule through action of another." Model Code, supra note 4, DR 9-102(A)(2). In this case, the lawyer would be using the uninformed client to enable the lawyer to circumvent the requirements of DR 9-102(A)(2).

149 See Committee on Legal Ethics v. Tatterson, 352 S.E.2d 107, 113 (W. Va. 1986). A client who agrees to pay a contingent fee exceeding the risk of no recovery—though he can afford to pay an hourly fee, has been informed of the hourly fee choice, and presented with the risk—has probably not understood the discussion of risk and has not given his "fully informed consent." In a "contingent-fee contract [t]he client needs to be fully informed as to the degree of risk justifying a contingent fee." Id. at 113. See Florida Bar v. Moriber, 314 So. 2d 145, 148 (Fla. 1975); In re Kutner, 78 Ill. 2d 157, 35 III. Dec. 157, 399 N.E.2d 963 (1979); Wunschel Law Firm v. Clabough, 291 N.W.2d 331, 336 (Iowa 1980); Cooper & Keys v. Bell, 127 Tenn. 142, 153 S.W. 844 (1912); Cal. Rule 2-107(B)(9) ("[t]he informed consent of the client to the fee agreement"); cf. Schenck v. Hill, Lent & Troscher, N.Y.L.J., July 11, 1988, at 30, col. 3 (N.Y. Sup. Ct. July 11, 1988). In Schenck, a lawyer hired to sue another lawyer for malpractice was himself a potential defendant in the same action, and obtained client consent to waive the conflict of interest. In disqualifying the lawyer, the court said: "the consent obtained in this case does not reflect a full understanding of the legal rights being waived. . . . [T]he unsophisticated client, relying upon the confidential relationship with his lawyer, may not be regarded as able to understand the ramifications of the conflict, however much explained to him." Id.

150 Model Rules, supra note 4.

151 The New York State Bar Association has rejected proposing that the appellate divisions adopt the Model Rules. See Law. Man. on Prof. Conduct, Current Reports (ABA/BNA) 77 (Mar. 16, 1988). Further, the presiding justices of the appellate division have indicated that they will not act contrary to the position taken by the Bar Association. Wise, State Bar Delegates Refuse to Adopt New Conduct Rules, N.Y.L.J., Nov. 6, 1985, col. 3, at 1.
Where a rule deviates from the Code the “Model Code Comparison” states the deviation; where no change is noted, the Rules, though using different language, are not deviating from the Code’s position on that subject.

Rule 1.15(a), the Rules’ counterpart to DR 9-102(A), states in pertinent part:

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. Other property shall be identified as such and appropriately safeguarded. . . .

In commenting on the legal background of Rule 1.15, the drafters stated that “[f]unds are often given to a lawyer for payment of costs or as an advance from which fees may be drawn when earned.” This strongly infers that the drafters intended that advance fees are “property of clients . . . in a lawyer’s possession” and are to be held “separate from the lawyer’s own property, and if this property consists of funds, then these [f]unds shall be kept in a separate account. . . .” Since these advance fees are to be “drawn when earned,” they cannot be deposited to the lawyer’s general office or personal account because they would immediately lose this separate identity. The only way in which advance fees may be “drawn when earned” is if they are deposited into a security account. Since the Model Rules, in the “Code Comparison” to Rule 1.15, do not indicate that it is changing the Code by providing that advance fee payments are to be deposited to a security account, it is confirming that the drafters of the Model Rules regarded the Model Code as providing that the depository requirements for “funds of clients” also apply to advance fee payments—that is, that “funds of clients” include advance fee payments.
CONCLUSION

Whether viewed from a textual, legal, or policy perspective, the position of N.Y. 570 and the other adherents of the minority position is indefensible. It is inconsistent with the text of the Code of Professional Responsibility and of the Rules of Professional Conduct; it seeks to replace fiduciary law with commercial law to govern the attorney-client relationship; and it accentuates the likelihood of loss of client funds at a time when the losses sustained by advance fee paying clients aggregate as much or more than all other categories of client loss. In seeking to elevate the interests of the attorney above those of the client, it runs counter to the very purposes of the Code of Professional Responsibility and the Rules of Professional Conduct. Even the features of the minority position that may be attractive to some lawyers because they ostensibly “protect” the lawyer by offering him a way around the Code- and Rule-mandated protections for the client, are little more than a snare and a delusion. The minority position raises attorneys’ chances of being disciplined for failing to promptly return any unearned fee payments in violation of DR 2-110(A)(3), it increases the likelihood of commingling funds and of misappropriation or unintentional embezzlement by attorneys, and it enlarges attorneys’ exposure to liability due to loss of the funds. Additionally, attorneys in states adopting the minority view may be subjected to less favorable tax treatment. Accordingly, the New York Committee on Professional Ethics and other adherents of the minority view should reconsider their determination that advance fee payments are not “funds of clients” within the ambit of DR 9-102, and should declare that advance fee payments must be deposited to client security accounts and withdrawn only when indisputably earned.

advance for specific services yet to be performed continue to belong to the client until the attorney performs the services.” Comment, supra note 39, at 437 (footnotes omitted; emphasis added). The note cited Carpenter, supra note 39, at 340 (“It has been suggested that [advance fees] should always be held in a segregated trust account, but DR 9-102 does not make this clear.”). Since this Legal Background Section comment was omitted from the final proposed draft of the Rules, it may reasonably be concluded that the drafters rejected the view that the Model Code did not include advance fee payments within the ambit of “funds of clients,” as well as the view that the Model Rules should fail to follow the Model Code’s position on advance fees.