Case No. C8-84-1650

STATE OF MINNESOTA
IN SUPREME COURT

In the Matter of the Petition of the Minnesota State Bar Association, a Corporation, with Regard to Rules 1.15 and 8.4 of the Minnesota Rules of Professional Conduct.

PETITION

TO THE SUPREME COURT OF MINNESOTA:

Petitioner, Minnesota State Bar Association (MSBA), states:

1. Petitioner is a not for profit corporation of attorneys admitted to practice law before this Court.

2. This Court, under its constitutionally-vested judicial power, has inherent and exclusive power to prescribe conditions upon which persons may be admitted to practice in the courts of Minnesota, and to supervise the conduct of attorneys admitted to practice in Minnesota.

3. The Minnesota Rules of Professional Conduct (Minnesota Rules) were adopted by the Minnesota Supreme Court, effective September 1, 1985, as the standard of professional responsibility for lawyers admitted to practice in Minnesota. The Minnesota Rules are based on the American Bar Association Model Rules of Professional Responsibility (ABA Model Rules).

4. Prior to September 1, 1985, the Minnesota Code of Professional Responsibility proscribed sexually harassing conduct by a lawyer through DR 1-102(A)(6), which forbade a lawyer to "engage in any other conduct that adversely reflects on his fitness to practice law." The status of this proscription against harassment and other unacceptable behavior by lawyers was placed in doubt when the Minnesota Rules were adopted.

5. The successor to 1-102(A)(6) is Rule 8.4(b), which forbids a lawyer to "commit a criminal act that reflects on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects" (emphasis added). Non-criminal harassment is not explicitly included in this proscription.

6. The Ad Hoc Committee on Rule 8.4(b) (Ad Hoc Committee) was established in October 1988 to assess the need for amendments to the Minnesota Rules to proscribe non-criminal sexual harassment. The committee recommended to the MSBA Board of Governors that the MSBA petition the Minnesota Supreme Court to amend Rule 8.4 to provide that it shall be professional misconduct to harass a person on the basis of sex, race, age, creed, religion, color, national origin, disability, or marital status, while the lawyer is acting in a professional capacity.

7. The elements or bases for harassment identified in the proposed amendment were selected from those cited in the Minnesota Human Rights Act.

8. Proposed comments for the proposed amendment were prepared by William J. Wernz, Director of the Office of Lawyers Professional Responsibility. The comments were not adopted by the Ad Hoc Committee. The Ad Hoc Committee report and the draft comments are attached.

9. The MSBA Board of Governors adopted the Ad Hoc Committee report with one revision: the words "sexual preference" were added as an element of prohibited misconduct.

10. The MSBA General Assembly adopted the Ad Hoc Committee report, as revised by the Board of Governors, with one revision: the words "while the lawyer is acting in a professional capacity" were deleted. The General Assembly adopted the recommendation that the MSBA petition the Minnesota Supreme Court to adopt this amendment, as indicated below.

11. The MSBA General Assembly also adopted the recommendation that the MSBA petition the Minnesota Supreme Court to adopt an amendment to the Minnesota Rules of Professional Conduct patterned after an American Bar Association Model Rule (ABA Model Rule) relating to trust account overdraft notification. The ABA Model Rule sets forth a program under which attorney disciplinary authorities would be automatically notified whenever a client trust account becomes overdrawn. A copy of the ABA Model Rule and report is attached.

12. The ABA Model Rule was studied by the MSBA Trust Account Overdraft Notification Committee, appointed in September

1988 to determine whether the ABA Model Rule should be recommended for adoption in Minnesota. The Committee recommended to the MSBA Board of Governors that the MSBA petition the Minnesota Supreme Court to adopt the ABA Model Rule in Minnesota through changes in Rule 1.15 of the Minnesota Rules. A copy of the Trust Account Overdraft Notification Committee report is attached.

13. The Committee recommended in its report that the Rules on Lawyers Professional Responsibility be amended to specify that a notice of overdraft would not be construed as an investigation file until the staff of the Office of Lawyers Professional Responsibility had determined that there was "a reasonable belief that misconduct may have occurred." Such procedures would allow inquiry by the Office in instances of bank error, bookkeeping mistakes and other error before an investigation file or complaint file would be opened. Specific language for such an amendment was not adopted by the Committee.

14. The Committee solicited reactions to the ABA Model Rule from the two principal banking organizations in Minnesota, the Independent Bankers of Minnesota and the Minnesota Bankers Association. Representatives from both groups indicated informally that they expected their member banks would cooperate with a mandatory overdraft reporting program if adopted by the Minnesota Supreme Court.

15. The MSBA Board of Governors and General Assembly adopted the Trust Account Overdraft Notification Committee report and recommendation that the MSBA so petition the Minnesota Supreme Court.

WHEREFORE, PETITIONER RESPECTFULLY REQUESTS that the Court amend Rule 1.15 of the Minnesota Rules of Professional Conduct to add provisions (i) through (n), and 8.4 of the Minnesota Rules to add provision (g), as follows:

Rule 1.15 Safekeeping Property

(i) Lawyer trust accounts shall be maintained only in financial institutions approved by the Office of Lawyers Professional Responsibility.

(j) A financial institution shall be approved as a depository for lawyer trust accounts if it shall file with the Office of Lawyers Professional Responsibility an agreement, in a form provided by the Office, to report to the Office in the event any properly payable instrument is presented against a lawyer trust account containing insufficient funds, irrespective of whether or not the instrument is honored. The Lawyers Professional Responsibility Board shall establish rules governing approval and termination of approved status for financial institutions, and shall annually publish a list of approved financial institutions. No trust account shall be maintained in any financial institution which does not agree to make such

reports. Any such agreement shall apply to all branches of the financial institution and shall not be cancelled except upon (3) days notice in writing to the Office.

(k) The overdraft notification agreement shall provide that all reports made by the financial institution shall be in the following format:

(1) In the case of a dishonored instrument, the report shall be identical to the overdraft notice customarily forwarded to the depositor, and should include a copy of the dishonored instrument, if such a copy is normally provided to depositors.

(2) In the case of instruments that are presented against insufficient funds but which instruments are honored, the report shall identify the financial institution, the lawyer or law firm, the account number, the date of presentation for payment and the date paid, as well as the amount of overdraft created thereby.

Such reports shall be made simultaneously with, and within the time provided by law for notice of dishonor, if any. If an instrument presented against insufficient funds is honored, then the report shall be made within (5) banking days of the date of presentation for payment against insufficient funds.

(l) Every lawyer practicing or admitted to practice in this jurisdiction shall, as a condition thereof, be conclusively deemed to have consented to the reporting and production requirements mandated by this rule.

(m) Nothing herein shall preclude a financial institution from charging a particular lawyer or law firm for the reasonable cost of producing the reports and records required by this rule.

(n) DEFINITIONS

"Financial Institution" - includes banks, savings and loan associations, credit unions, savings banks and any other business or person which accepts for deposit funds held in trust by lawyers.

"Properly payable" - refers to an instrument which, if presented in the normal course of business, is in a form requiring payment under the laws of this jurisdiction.

"Notice of dishonor" - refers to the notice which a financial institution is required to give, under the laws of this jurisdiction, upon presentation of an instrument which the institution dishonors.

Rule 8.4 Misconduct

It is professional misconduct for a lawyer to:

(a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;

(b) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects;

(c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation;

(d) engage in conduct that is prejudicial to the administration of justice;

(e) state or imply an ability to influence improperly a government agency or official.

(f) knowingly assist a judge or judicial officer in conduct that is a violation of applicable rules of judicial conduct or other law; or

(g) harass a person on the basis of sex, race, age, creed, religion, color, national origin, disability, sexual preference or marital status.

Dated: 7.25.89

Minnesota State Bar Association
A Not for Profit Corporation

By: _____
Ralph H. Peterson, President

By: _____
Philip K. Arzt, Chairperson
Ad Hoc Committee on Rule 8.4(b)

By: _____
R. Walter Bachman, Chairperson
Trust Account Overdraft
Notification Committee

Attachments:
Report of the MSBA Ad Hoc Committee on Rule 8.4(b)
ABA Model Rule and Report
Report of the Trust Account Overdraft Notification Committee

MINNESOTA STATE BAR ASSOCIATION

MINNESOTA BAR CENTER • SUITE 403, 430 MARQUETTE AVE. • MINNEAPOLIS, MN 55401

DATE: June 6, 1989

TO: MSBA House of Delegates

Enclosed is a copy of the final report of the Ad Hoc Committee on Rule 8.4(b). This report was adopted by the Board of Governors on May 6, 1989, with one amendment: to include harassment based on sexual preference as an element of prohibited misconduct. The language thus reads:

> (g) harass a person on the basis of sex, race, age, creed, religion, color, national origin, disability, sexual preference, or marital status, while the lawyer is acting in a professional capacity.

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Minnesota State Bar Association
Ad Hoc Committee on Rule 8.4(b)
Final Report

In October 1988, the Minnesota State Bar Association established a committee to review the Minnesota Rules of Professional Conduct, and to assess the need for amendments to proscribe non-criminal sexual harassment. A. Patrick Leighton, President of the Minnesota State Bar Association, named the following individuals to serve on the ad hoc committee:

Philip Arzt, Bloomington, Chairperson
Gregory Bistram, St. Paul
Janet Dolan, New Brighton
Fenita Foley, St. Paul (public member)
Joan Hackel, St. Paul
Keith Hughes, St. Cloud
Phyllis Karasov, St. Paul
Charles Keffer, St. Paul (public member)
Kenneth Kirwin, St. Paul
Jack Nordby, Minneapolis
Glenn Oliver, Minneapolis
James Schlichting, Albert Lea
Betty Shaw, St. Paul
Richard Wexler, Minneapolis

The committee has also received able assistance from Minnesota State Bar Association Associate Executive Director Mary Jo Ruff.

History

Prior to September 1, 1985, sexually harassing conduct by an attorney had been proscribed by the Minnesota Code of Professional Responsibility, DR 1-102(A)(6), which forbade a lawyer to "engage in any other conduct that adversely reflects on his fitness to practice law." Two cases brought the matter to the attention of the public in July and August, 1988, when the Minnesota Supreme Court suspended and reprimanded Ramsey County District Court Judge Alberto Miera and reprimanded Geoffrey Peters, former dean of William Mitchell College of Law, for sexual harassment. The status of the proscription against sexual harassment by attorneys was placed in doubt when the Minnesota Supreme Court adopted the Rules of Professional Conduct, which became effective on September 1, 1985. Rule 8.4(b) forbids a lawyer to "commit a criminal act that reflects on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects." Non-criminal sexual harassment is not explicitly included in this proscription.

Against this background, the Minnesota State Bar Association directed the ad hoc committee to review the existing Minnesota Rules of Professional Conduct as they might apply to the areas of non-consensual sexual conduct and, if deemed appropriate, to make recommendations for amendment. The committee considered whether to define its mission narrowly, by considering only the type of conduct disciplined by the court in the Peters and Miera cases; or more broadly, by prohibiting all non-consensual sexual conduct or other forms of discriminatory conduct by attorneys. The committee reviewed the Peters and Miera decisions, an article from the Georgetown Journal of Legal Ethics, and rules, proposed rules and opinions from other jurisdictions. The committee met five times from October, 1988 to March, 1989. During its deliberations, the committee reviewed more than a dozen varied proposals for amendments or modification of the existing Minnesota Rules of Professional Conduct, and also discussed the option of not making any recommendation for rule changes.

Recommendations

I. The committee recommends that Rule 8.4 of the Minnesota Rules of Professional Conduct be amended to read as follows:
Rule 8.4 Misconduct

It is professional misconduct for a lawyer to:

(a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;

(b) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects;

(c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation;

(d) engage in conduct that is prejudicial to the administration of justice;

(e) state or imply an ability to influence improperly a government agency or official;

(f) knowingly assist a judge or judicial officer in conduct that is a violation of applicable rules of judicial conduct or other law; or

(g) harass a person on the basis of sex, race, age, creed, religion, color, national origin, disability, or marital status, while the lawyer is acting in a professional capacity.

The foregoing amendment to Rule 8.4 was adopted after first narrowing the proposals from a list of eleven to five. The elements or basis for harassment identified in the proposed amendment are selected from those cited in the Minnesota Human Rights Act.

William J. Wernz, the director of the office of the Lawyers Professional Responsibility Board, prepared proposed comments for this rule amendment which were not adopted by the committee, and are not part of the committee's recommendation; but those comments are appended to this report.

II. The committee recommends that the Minnesota State Bar Association establish and appoint an ad hoc committee to consider and further study discrimination in the practice of law particularly as it may apply to employment and advancement, and to prepare recommendations to the Minnesota State Bar Association for possible additional amendments to the Minnesota Rules of Professional Conduct regarding discrimination.

The committee considered recommending a second amendment to Rule 8.4 of the Minnesota Rules of Professional Conduct which would make it professional misconduct for a lawyer to:

> "unlawfully discriminate in hiring, promoting or otherwise determining conditions of employment on the basis of race, age, creed, color, national origin, sex, disability or marital status, while the lawyer is acting in a professional capacity."

The committee failed to adopt this recommendation on a divided vote. The committee believed that this additional rule amendment would exceed the scope and authority of the committee. At the same time, it is the consensus of the committee that the work of this committee on harassment should be a starting point for further work focused on other forms of discrimination in the legal profession. Such a committee could be a continuation of the Rule 8.4 ad hoc committee augmented by additional members, providing additional diversity of focus on this broader issue.

Comment–1985, 1989

People dealing with lawyers in a law-related setting should not be harassed sexually or because of racial, religious or ethnic identiy. Improper harassment includes conduct such as that disciplined in In re Miera, 426 N.W.2d 850 (Minn. 1988), and in In re Peters, 428 N.W.2d 375 (Minn. 1988). The Minnesota Human Rights Act also assigns relevant meanings for the term "sexual harassment." Sexual, racial, ethnic or religious harassment also includes the use of certain epithets and negative references to such identities. For example, see In re Williams, 414 N.W.2d 397-8 (Minn. 1987).

Illegal "discrimination" does not necessarily amount to harassment. Harassment forbidden by this rule involves active burdening of another, rather than mere passive failure to act properly. Nor does Rule 8.4(g) extend to activities unconnected with the practice of law. The Rule does not forbid legitimate inquiry into sexual, racial religious or ethnic matters when any such matter is properly related to the legal representation.

ABA MODEL RULE FOR TRUST ACCOUNT OVERDRAFT NOTIFICATION

Adopted by the American Bar Association
House of Delegates, February 9, 1988

A. CLEARLY IDENTIFIED TRUST ACCOUNTS REQUIRED

Attorneys who practice law in this jurisdiction shall deposit all funds held in trust in this jurisdiction in accordance with Rule 1.15(a) of the Model Rules of Professional Conduct in accounts clearly identified as "trust" or "escrow" accounts, referred to herein as "trust accounts", and shall take all steps necessary to inform the depository institution of the purpose and identity of such accounts. Funds held in trust include funds held in any fiduciary capacity in connection with a representation, whether as trustee, agent, guardian, executor or otherwise. Attorney trust accounts shall be maintained only in financial institutions approved by the state's highest court or the state lawyer discipline agency.

B. OVERDRAFT NOTIFICATION AGREEMENT REQUIRED

A financial institution shall be approved as a depository for attorney trust accounts if it shall file with the state's highest court or the state lawyer disciplinary agency an agreement, in a form provided by the court or disciplinary agency, to report to the disciplinary agency in the event any properly payable instrument is presented against an attorney trust account containing insufficient funds, irrespective of whether or not the instrument is honored. The court or disciplinary agency shall establish rules governing approval and termination of approved status for financial institutions, and shall annually publish a list of approved financial institutions.

No trust account shall be maintained in any financial institution which does not agree to make such reports. Any such agreement shall apply to all branches of the financial institution and shall not be cancelled except upon [30] days notice in writing to the court or disciplinary agency.

C. OVERDRAFT REPORTS

The overdraft notification agreement shall provide that all reports made by the financial institution shall be in the following format:

(1) In the case of a dishonored instrument, the report shall be identical to the overdraft notice customarily forwarded to the depositor, and should include a copy of the dishonored instrument, if such a copy is normally provided to depositors;

(2) In the case of instruments that are presented against insufficient funds but which instruments are honored, the report shall identify the financial institution, the attorney or law firm, the account number, the date of presentation for payment and the date paid, as well as the amount of overdraft created thereby.

Such reports shall be made simultaneously with, and within the time provided by law for notice of dishonor, if any. If an instrument presented against insufficient funds is honored, then the report shall be made within [5] banking days of the date of presentation for payment against insufficient funds.

D. CONSENT BY ATTORNEYS

Every attorney practicing or admitted to practice in this jurisdiction shall, as a condition thereof, be conclusively deemed to have consented to the reporting and production requirements mandated by this rule.

E. COSTS

Nothing herein shall preclude a financial institution from charging a particular attorney or law firm for the reasonable cost of producing the reports and records required by this rule.

REPORT

INTRODUCTION

Under Rule 1.15(a) of the ABA Model Rules of Professional Conduct, a lawyer must maintain client funds in an account separate from the lawyer's own property.* It is difficult to think of a more serious violation of attorney ethics than misappropriation of client funds. This proposed Rule for Trust Account Overdraft Notification is intended to help prevent misappropriation by providing a method for early warning of improprieties in the handling of attorney trust accounts. The Rule requires attorneys to maintain trust accounts in financial institutions which agree to provide state disciplinary agencies with notice whenever an instrument drawn on a trust account is dishonored, or when a trust account is overdrawn.

The two most obvious indications of possible misappropriation by an attorney of his/her client's trust funds are an account overdraft or a bounced trust account check. Johnson, Lawyer, Thou Shall Not Steal, 36 Rutgers L. Rev. 454, 555 (1985). In fact, the case law is replete with examples in which these indicia of trust fund violations were available years before the attorney was exposed and subsequently disciplined. For example, in In re Achmetov, 89 N.J. 121, 445 A.2d 36 (1982), evidence showed that there were 23 instances of bank overdrafts totalling $71,000 during 1975 to 1976, and yet, the first ethics complaint was not filed until one to two years later. Id. at 123, 445 A.2d at 37.

If the indications of financial improprieties could be detected immediately, prevention of further mishandling of client accounts could be achieved. Overdraft notification programs address this problem by enabling the state disciplinary agency to monitor attorneys' handling of trust funds and to uncover defalcations before they involve substantial sums and numerous clients. See Hecht, Audit Procedures for Lawyer's Trust Accounts: Their Use and Benefit 6 (1985).

* Model Rule 1.15 (a) provides: 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. 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 termination of the representation.

F. DEFINITIONS

"Financial institution" - includes banks, savings and loans associations, credit unions, savings banks and any other business or person which accepts for deposit funds held in trust by attorneys.

"Properly payable" - refers to an instrument which, if presented in the normal course of business, is in a form requiring payment under the laws of this jurisdiction.

"Notice of dishonor" - refers to the notice which a financial institution is required to give, under the laws of this jurisdiction, upon presentation of an instrument which the institution dishonors.

A trust account overdraft notification program requires that the relevant state disciplinary body be notified whenever a check drawn on a client trust account is presented against insufficient funds. For checks which are dishonored, the drawee institution merely provides the disciplinary agency with a duplicate of the notice normally provided to the drawer. For checks which are honored despite the absence of sufficient funds, the drawee institution must provide official notice to the disciplinary agency. This is not a significant burden, because in such circumstances the institution is almost certain to provide some form of notice to the drawer, and can merely provide a duplicate to the disciplinary agency.

An overdraft notification program is not intended to result in the discipline of every attorney who overdraws a trust account. Such a program can provide for an attorney, or financial institution, to explain occasional errors. This type of program merely assures that appropriate authorities receive early warning of improprieties, so that corrective action can be taken where necessary.

Other measures not required under present ABA rules have been employed to prevent trust account violations. One such measure involves random auditing of attorney trust accounts. In jurisdictions using random audit, trust account records for a small percentage of attorneys, randomly selected, are examined to determine whether the records involved appear to be in compliance with ethical requirements for such accounts. If deficiencies are discovered, the attorney is given an opportunity to correct them. If indications of misappropriation, commingling or other unethical handling of trust funds appear, the attorney's records are subject to a more thorough "for cause" audit. The random audit system can serve as a deterrent against mishandling of trust funds, as a method for educating lawyers concerning their duties with respect to trust accounts and as a method for discovering and halting intentional violations of the rules of ethics.

Another preventive measure used in some jurisdictions is the recordkeeping certification system, under which specific minimum recordkeeping requirements are established, and attorneys are required to certify annually that they are in compliance with those requirements. Check stubs, check books , general ledgers and similar documents are among the records generally required to be maintained under recordkeeping certification rules.

JURISDICTIONS CURRENTLY USING OVERDRAFT NOTIFICATION

Four states have adopted trust account overdraft notification programs: Florida, see Rules Regulating the Florida Bar, Rule 5-1.2(c)(4) (1986); New Jersey, see New Jersey Supreme Court Rule 1:21-6(a)(2) (1985); North Carolina, see North Carolina Code of Professional Responsibility, DR 9-102(b)(6) (1984); and Virginia, see Rules of the Virginia Supreme Court of Appeals, DR 9-103(B)(1) (1980). The overdraft notification programs in these states fall

into two broad categories. One type of program involves an agreement between the attorney and a financial institution that notice will be provided to disciplinary authorities. The other requires an agreement that notification will be provided between a financial institution and the state's highest court as a pre-condition of the institution's holding of client trust funds.

In Florida, North Carolina and Virginia, the attorney has the burden of ensuring overdraft notification; rules in those states require the attorney to secure an agreement with a financial institution to report all overdrafts to the appropriate state disciplinary agency. If the attorney cannot secure such an agreement, the attorney must, within a reasonable time, seek another institution in which to deposit the trust funds.

There are two serious disadvantages to such a system. First, it is difficult to monitor whether all attorneys have complied with the rule, and even more difficult to determine whether they remain in compliance at all times. Second, because this system requires each attorney to contract with a financial institution to provide overdraft notification, the only person in a position to enforce the contract is the attorney. The rules do not require a direct agreement between the financial institution and the court. Therefore, if the financial institution fails to provide notice, the only person in a position to know of this failure and to complain is the very person who has the least incentive to reveal that improper conduct has occurred: the attorney.

In New Jersey, an attorney cannot maintain an account in a financial institution that has not been approved by the supreme court. An institution is approved if it files with the court an agreement to report all overdrafts to the state disciplinary agency. The names of all the approved institutions are published in the local law journal. The sanction for failing to report overdrafts is withdrawal of the court's approval. The rule, therefore, ensures compliance because financial institutions will choose to report overdrafts rather than risk the loss of attorneys' business. The Committee recommends in its proposed Model Rule the adoption of the New Jersey procedure.

EXPLANATION OF MODEL RULE PROVISIONS

A. Clearly Identified Trust Accounts Required

Section A. of this Rule sets forth the requirement for deposit of trust funds in clearly identified trust accounts in approved financial institutions. The Rule applies to all funds held under Rule 1.15(a) of the Model Rules of Professional Conduct (For text of Rule 1.15(a), see footnote on first page of this report). Funds held not "in connection with a representation", such as a trust fund for a lawyer's own spouse or minor child, do not fall under the

Rule. An attorney's own funds properly held in a non-fiduciary capacity, such as funds in a business or personal account, do not fall under the Rule.

It should be noted that although Model Rule of Professional Conduct 1.15 generally requires that trust accounts be maintained in the state where the lawyer's office is situated, trust property may be held outside the lawyer's home jurisdiction upon consent of the client. The overdraft notification rule governs funds held within the adopting state. A lawyer's obligation to deposit trust funds in an approved institution will arise upon adoption of the overdraft notification rule in a state where the lawyer deposits trust funds, whether that state is the state wherein the lawyer's office is situated or some other state.

B. Overdraft Notification Agreement

Under the proposed model rule, each institution wishing to be approved as a depository of client trust funds must file an overdraft notification agreement with the state's highest court. In some jurisdictions, the court may wish to delegate to the state bar or some other agency the duty to enter into overdraft notification agreements with financial institutions and to publish a list of approved institutions.

The overdraft notification agreement requires that all overdrafts be reported to the state lawyer disciplinary agency, irrespective of whether or not the instrument is honored. In light of the purposes of this model rule, and in view of ethical proscriptions concerning the preservation of client funds and commingling of client and attorney funds, it would be improper for an attorney to accept "overdraft privileges" or accept any other arrangement for a personal loan on a client trust account in exchange for the institution's promise to delay or not to report an overdraft.

This denial of discretion in financial institutions serves two important purposes. First, it makes notification by a financial institution an administratively simple matter. An institution which receives an instrument for payment against insufficient funds need not evaluate whether circumstances require that notification be given; it merely provides notice. It then becomes the responsibility of the discipline agency to determine whether further action is necessary.

Second, mandatory notification shields the institution from potential tort claims by clients for failure to report overdrafts. Liability for negligence in reporting overdrafts could flow to any party injured by the failure to report to whom a duty to report is owed and who falls within the zone of foreseeability. Arguably, an

institution could owe a duty to clients whose funds are involved, and to the clients' security fund. If an institution reports all overdrafts, then its potential liability for negligent failure to report is minimized.

In cases where a bounced check or overdraft is a result of an accounting error (caused by either the attorney or the institution), but notification has already been sent to the state agency, the institution should provide the attorney with a written explanation (preferably, an affidavit from an officer of the institution) which the attorney can then submit to the agency to verify the error.

The model rule calls for the state high court (or disciplinary agency, where the court has so delegated) to establish rules governing approval of financial institutions' holding of client trust funds, and termination of approved status. Such rules should specify under what circumstances approval will be withdrawn. In accordance with the New Jersey program, the court's rules might state that where an institution occasionally or negligently fails to report an overdraft, the court will not remove it from the list of approved institutions. See Overdraft Implementation Guidelines, 115 N.J.L.J. p.1, col.1 (Feb. 14, 1985). However, where the institution demonstrates "a pattern of neglect or a showing of bad faith" in failure to comply with the proposed model rule, approval may be revoked. Id.

C. Overdraft Reports

The model rule provides the proper format for overdraft reports. In so doing, the rule distinguishes between dishonored instruments and instruments that are presented against insufficient funds but honored. Where instruments are dishonored, a copy of the notice of dishonor is sufficient. Where instruments are presented against insufficient funds but paid, the rule specifies the information that the institution should provide.

Ordinarily, an institution gives notice of an overdraft within 24 hours of dishonor to a depositor whose account is charged. See Uniform Commercial Code §3-508(2) ( ). This is the same time period in which overdraft notification is given to the state disciplinary agency. Where an instrument presented against insufficient funds is honored, the financial institution should send overdraft notification to the agency within 5 days of the date of presentation.

Upon receipt of the overdraft notification, the rule contemplates that the state agency will contact the attorney or firm by telephone and request an explanation for the overdraft. A letter may also be sent requesting a documented explanation. If the overdraft is an accounting error, the attorney or firm submits his/her written explanation, including any documents to substantiate the claim.

Where the attorney or firm cannot supply an adequate or complete explanation for the overdraft, other action may be generated, including an audit or a demand for production of the attorney's books and records.

D. Consent by Attorneys

The proposed rule establishes that consent to the reporting and production requirements mandated by the rule is a condition of the privilege to practice law in a jurisdiction which has adopted the rule. This condition is intended to protect financial institutions from claims by attorney-depositors based on disclosures made by financial institutions, provided that such disclosures are in accordance with the rule. Parties to an overdraft notification agreement are the court and a financial institution. The consent provision in the rule avoids the necessity for financial institutions to draft separate agreements with attorneys to establish consent to overdraft notification.

E. Costs

In addition to normal monthly maintenance fees on each account, the attorney or firm can anticipate additional fees to be charged by the financial institutions for reporting overdrafts in accordance with this Rule. See Johnson, Lawyer, Thou Shall Not Steal, 36 Rutgers L. Rev. 454, 555 (1985)(institutions could reasonably raise their existing charges for the notification service). However, because financial institutions already flag overdrafts and returned checks, it appears only slightly more burdensome for the institution to forward a copy to the local disciplinary agency. Id. As a result, the additional cost to the attorney should not be exorbitant.

Section E. should not be interpreted to allow an attorney to permit trust account funds to be reduced through deductions made by a financial institution to cover costs of overdraft notification. If such costs are charged, the should not be born by clients.

F. Definitions

Under the laws of most jurisdictions, the definition of "properly payable" will be contained in Uniform Commercial Code Sec. 4-104.

Under the laws of most jurisdictions, the definition of "notice of dishonor" will be determined by reference to Uniform Commercial Code Sec. 3-508 (2), under which notice must be given by a bank before its midnight deadline and by any other person or institution before midnight on the third business day after dishonor or receipt of notice of dishonor.

CONCLUSION

Implementation of an overdraft notification program in the various jurisdictions promises to significantly reduce the level of attorney defalcations across the country. Such a program provides an invaluable "early warning" that an attorney is engaging in conduct likely to injure clients. The receipt of such information will permit appropriate disciplinary authorities to intervene before large losses occur and significant numbers of clients are harmed. It will allow authorities to counsel errant attorneys to take corrective action before their improper conduct becomes so egregious as to mandate disbarment.

An overdraft notification program is administratively simple. Financial institutions ordinarily report overdrafts to depositors and it is therefore only slightly more burdensome for the information to be sent to disciplinary authorities. Given the lucrative value of maintaining attorney trust accounts, it is unlikely that institutions will refuse to agree to provide notification and therefore become ineligible to hold trust accounts. Further, any costs of providing notification can be passed along to attorneys who create an overdraft.

It is anticipated that ultimately an overdraft notification program will save thousands of dollars for both clients and client security funds. In discussing the need for such programs, one commentator has stated: "One can confidently assert that such a step is the single most important action that can be taken today short of the total abolition of trust accounts...". Johnson, supra, at 555.(emphasis in original)

Based on the foregoing, the Standing Committee on Lawyers' Responsibility for Client Protection and the Standing Committee on Professional Discipline recommend the adoption of the proposed model rule providing for overdraft notification procedures to serve as a model for implementation by the states.

MINNESOTA STATE BAR ASSOCIATION
TRUST OVERDRAFT NOTIFICATION COMMITTEE REPORT

May, 1989

During September, 1989, President A. Patrick Leighton, Minnesota State Bar Association, appointed the following persons as members of the Trust Overdraft Notification Committee:

R. Walter Bachman, Chairperson, Minneapolis
James E. Broberg, Albert Lea
William S. Fallon, St. Paul
Timothy J. Looby, Waconia
Patricia O'Gorman, Cottage Grove
Melvin I. Orenstein, Minneapolis
William J. Wernz, St. Paul

The committee also received very able assistance from Minnesota State Bar Association Staff Liaison member, Ms. Mary Jo Ruff.

The committee's mandate was to determine whether a proposed American Bar Association Model Rule pertaining to Trust Account Overdraft Notification should be recommended for adoption in Minnesota. The ABA Model Rule was adopted by the ABA House of Delegates on February 9, 1988. The Model Rule, a copy of which is attached, sets forth a program under which attorney disciplinary authorities would be automatically notified whenever a client trust account became overdrawn. In addition to adoption by the ABA House of Delegates, the Model Rule was actively recommended for adoption by the ABA Standing Committee on Lawyers' Responsibility for Client Protection. At last report, some form of overdraft notification system had been adopted in the following states:

California
Florida
Idaho
Maryland
Nebraska
New Jersey
New York (some departments only)
North Carolina
Virginia

Since at least 10 to 15 other states are known to be considering adoption of an overdraft notification, it is likely that at least several additional states will have adopted such a program by mid-1989.

As a part of its deliberations, the committee made contact with bar representatives in several states seeking information regarding the operation of overdraft notification

systems in those states. Contact was also made with the staff of the Lawyers Professional Responsibility Board (Bill Wernz, Director, was a committee member). Because the program would require a measure of cooperation from banks located throughout the state, reactions were solicited from the two principal banking organizations, The Independent Bankers of Minnesota and The Minnesota Bankers Association.

Following its inquiry and deliberations, the committee unanimously agreed to recommend the adoption of the Model Rule for Trust Account Overdraft Notification in Minnesota. The committee concluded that a trust account overdraft notification system, while it would not serve as a panacea for preventing defalcations by attorneys or misuse of client trust funds, would be useful for both enforcement and educational purposes. The committee's recommendation was accompanied by one caveat: that the Lawyers Professional Responsibility Board adopt a special policy to deal with matters forwarded to its attention under the overdraft notification system. As discussed more fully below, the committee sought and received assurances from Minnesota's Office of Lawyers Professional Responsibility that new rules could and should be adopted to prevent every overdraft referral from being considered as a "complaint" on an attorney's disciplinary "record".

Questions considered by the committee during the course of its deliberations included the following:

1. Will the program be effective? Upon initial consideration, the reaction of some lawyers is to question the effectiveness of a program that only detects and deals with overdrafts of client trust accounts. How, they ask, could such a system ever detect serious attorney misconduct if the attorney could avoid detection by simply leaving a small amount of funds in the trust account or by failing to keep client funds in the required trust account? To assist in answering this question, the committee made contact with authorities from several other states that have overdraft notification systems, including New Jersey, and the committee concluded that such programs have had a significant enforcement effect. Recognizing that an accomplished lawyer who proceeds with deliberate intent to convert client funds to his own use can always avoid detection under this rule, the fact remains that some of our fellow attorneys, albeit a very small minority, convert client funds to their own use and create one or more trust account overdrafts in the process. The committee was informed of several instances of serious attorney misconduct in Minnesota involving attorneys who

were ultimately suspended or disbarred from practice, whose conduct would have been detected by an overdraft notification system. Moreover, New Jersey reports that it has detected several serious fund conversion cases directly as a consequence of the notification system. The committee also observed that the system has a non-disciplinary educational function, in that it serves as one more means of alerting attorneys to the rules regarding the handling of client trust funds. Even those overdraft referrals that involve no misconduct and result in no discipline may often cause the lawyer or law firm to review client fund handling policies to make every attempt to comply with the rules. Thus, the committee concluded that the overdraft notification system would have a beneficial effect.

2. Will the operation of the overdraft notification system cause the creation of an undue number of ethics "complaints" for bank errors, bookkeeping mistakes, or other unavoidable circumstances? The committee noted that the vast majority of referrals made to disciplinary authorities as part of a trust account overdraft notification system involved situations that should not give rise to any form of discipline. For example, some referrals are generated purely as a consequence of an error made within a bank. Other referrals may be caused by bookkeeping errors. One common source of referrals arises from dishonor of a check deposited in the trust account. The committee felt that these circumstances, and other similar ones showing no improper dealings by the attorney, should not be counted as a "complaint" by the Lawyers Professional Responsibility Board. To deal with this issue, the committee recommended that adoption of the Model Rule in Minnesota be accompanied by adoption of amendments to the Rules on Lawyers' Professional Responsibility, specifying that a notice of overdraft would not be construed by the Lawyers' Board as an investigation file until the Board's staff had determined that there was "a reasonable belief that misconduct may have occurred". Some of the states with overdraft notification systems have adopted such procedures. The Office of Lawyers Professional Responsibility, subject to subsequent Board review and approval, has indicated that it would favor such an operating policy and rule change. As a consequence, the committee anticipates that most of the notices to the Lawyers' Board would be subject to telephone inquiries or inquiry by correspondence, and that no

complaint file or investigative file would be opened in the name of the lawyer or law firm. If the lawyers provide a satisfactory explanation of the overdraft, therefore, no file would be maintained in the name of the attorney and no "record" of the notification would be created in the attorney's name.

3. Will banks participate in the program? The committee was concerned to determine whether Minnesota's banking community would cooperate with a mandatory trust account notification system. Any significant refusal to participate by the banking community could cause considerable inconvenience to attorneys, especially those located outside of the metropolitan areas. Through contacts with other states, the committee concluded that initial objections of some banking institutions to the program have been overcome and that very few banks have declined to participate. When our committee contacted the principal banking associations, we received no objection to the program from the Independent Bankers of Minnesota. The Minnesota Bankers Association, while officially taking "no position" on the issue, indicated its belief that its members would provide this service. We anticipate that fees charged by banks for the notification, which should be charged to the attorneys, will be in modest amounts and will not amount to a material added burden to Minnesota attorneys.

CONCLUSION

The Minnesota State Bar Association Overdraft Notification Committee recommends that the Minnesota State Bar Association petition the Minnesota Supreme Court for rule amendments necessary to implement this recommendation.

MINNESOTA STATE BAR ASSOCIATION

MINNESOTA BAR CENTER • SUITE 403, 430 MARQUETTE AVE. • MINNEAPOLIS, MN 55401

July 25, 1989

C8-84-1650

Clerk of the Appellate Courts
230 Capitol
St. Paul, Minnesota 55155

Re: In re Petition of the Minnesota State Bar Association to amend Rules 1.5 an 8.4 of the Minnesota Rules of Professional Conduct

Enclosed is the original and ten copies, as specified by your office, of a Petition for a change in Rules 1.5 and 8.4 of the Minnesota Rules of Professional Conduct.

The Minnesota State Bar Association requests permission to appear at a hearing if one is established on the Petition.

Sincerely,

Tim Groshens
Executive Director

TG:jg
Enclosures

MINNESOTA STATE BAR ASSOCIATION

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Executive Director
Tim Groshens

July 25, 1989

Clerk of the Appellate Courts
230 Capitol
St. Paul, Minnesota 55155

Re: In re Petition of the Minnesota State Bar Association to amend Rules 1.15 and 8.4 of the Minnesota Rules of Professional Conduct

Enclosed is the original and ten copies, as specified by your office, of a Petition for a change in Rules 1.15 and 8.4 of the Minnesota Rules of Professional Conduct.

The Minnesota State Bar Association requests permission to appear at a hearing if one is established on the Petition.

Sincerely,

Tim Groshens
Executive Director

TG:jg
Enclosures

MINNESOTA STATE BAR ASSOCIATION

MINNESOTA BAR CENTER • SUITE 403, 430 MARQUETTE AVE. • MINNEAPOLIS, MN 55401

July 27, 1989

Clerk of the Appellate Courts
230 Capitol
St. Paul, Minnesota 55155

Re: In re Petition of the Minnesota State Bar Association to amend Rules 1.15 and 8.4 of the Minnesota Rules of Professional Conduct

Enclosed is a substitute cover letter and first page to our Petition for a change in Rules 1.15 and 8.4 of the Minnesota Rules of Professional Conduct. Also enclosed are ten copies.

Sincerely,

Tim Groshens
Executive Director

TG:jg
Enclosures