Minnesota State Bar Association

MINNESOTA BAR CENTER • SUITE 403, 430 MARQUETTE AVE. • MINNEAPOLIS, MN 55401 • PHONE 612-333-1183
In-state 1-800-292-4152

President
CLINTON A. SCHROEDER
300 Roanoke Bldg.
Minneapolis, MN 55402
(612) 343-2800

July 1, 1982

John McCarthy
Clerk of the Supreme Court
State of Minnesota
230 State Capitol
St. Paul, MN 55155

Dear Mr. McCarthy:

Enclosed please find the original and 12 copies of a petition of the Minnesota State Bar Association to amend the Code of Professional Responsibility and to create a Lawyer Trust Account Board.

By copy of this letter, a copy of this petition is being transmitted to Michael J. Hoover, Director of the Lawyers' Professional Responsibility Board.

In addition to this office, please notify the following individuals of any scheduled hearing on this matter:

Allen I. Saeks, Chairman
Committee on Interest on Lawyers' Trust Accounts
1200 National City Bank Building
Minneapolis, MN 55402
Telephone: 339-1200

Clinton A. Schroeder, Past President
Minnesota State Bar Association
300 Roanoke Building
Minneapolis, MN 55402
Telephone: 343-2800

If there are any further questions, do not hesitate to contact us.

Sincerely,

Tim Groshens
Associate Executive Director

Executive Director CELENE GREENE

TG/rs

NO. A-8

STATE OF MINNESOTA

IN SUPREME COURT

In the Matter of the Petition of the Minnesota State Bar Association, a Corporation, for Amendment of DR 9-102 and 9-103, and to enact a new DR 9-104 of the Code of Professional Responsibility Relating to Trust Funds, and for Establishment of a Lawyer Trust Account Board.	))	PETITION TO AMEND THE CODE OF PROFESSIONAL RESPONSIBILITY AND TO CREATE A LAWYER TRUST ACCOUNT BOARD

TO THE SUPREME COURT OF THE STATE OF MINNESOTA:

Petitioner, Minnesota State Bar Association, states:

1. Petitioner is a non-profit corporation composed of attorneys at law duly licensed to practice law before this Court. Of the approximately 12,000 attorneys licensed to practice law in Minnesota, approximately 8,000 are members of the Minnesota State Bar Association (hereinafter "MSBA").

2. This Court regulates the management of client funds entrusted to lawyers through Disciplinary Rule 9-102 ("DR 9-102") of the Code of Professional Responsibility. This Disciplinary Rule requires that client funds be deposited in one or more identifiable bank accounts.

3. Traditionally, the majority of clients' funds has been held in trust in non-interest bearing checking accounts. Individual sums which could generate significant amounts of interest are often deposited by lawyers in interest bearing savings accounts and the interest generated thereon, less the costs of maintaining the account, is paid over directly

to the client. For the vast majority of sums, however, it is impracticable to establish separate interest bearing savings accounts for each client, or to attempt to compute the interest on individual sums commingled in a single savings account.

4. Recent developments in banking and tax law and in computer technology have made it possible through the use of interest bearing checking accounts (NOW accounts), and through other types of accounts, to identify and capture the interest currently being lost.

5. In recognition of its responsibility to apply the knowledge and experience of the profession to the public good, the MSBA, in June of 1981, appointed a committee on Interest on Lawyers' Trust Accounts. The committee, chaired by Allen I. Saeks of Minneapolis, was given the following charge:

> To monitor continuing developments among bar associations, the banking industry, the judicial system, and the Federal government regarding the use of interest earned on lawyers' trust accounts.
>
> To analyze and make recommendations to the Board of Governors on any use of such interest by the organized bar and the method of implementation of any such uses.

The committee included nine lawyers representing various types of law practices and geographic areas of the State. In addition, three non-lawyers, including (1) the President of the Citizen League of the Twin Cities, (2) an individual who is an active volunteer in widely-based community organizations, and (3) an elementary school principal, were members of the committee.

6. The committee studied materials from other states and foreign countries which had existing or proposed programs for capturing interest on funds in lawyers' trust accounts. Members of the committee met and communicated with representatives of various other state jurisdictions and a province of Canada, and discussed their programs with them.

7. Through its deliberations, the committee determined that changes in conditions have so affected the practicality of earning interest

on client funds that a requirement should be instituted requiring all client funds to be placed in some type of interest bearing account. (A full copy of the committee's report is attached hereto as "Exhibit A" and incorporated herein by reference.) These changes are:

(a) In 1980, Congress enacted legislation which permitted the use of Negotiable Order of Withdrawals (NOW) accounts. NOW accounts are interest bearing accounts subject to withdrawal on demand.

(b) Computer technology and increasing competition in the financial services industry have combined to make possible accounting of a type that can economically compute the total interest on a large number of commingled accounts containing funds which are held for short periods of time.

(c) Interest rates have increased substantially, making the "lost" interest on idle trust funds a matter of greater concern and tending to raise the level of administrative effort which is justified to capture the lost interest.

8. The committee further determined that although the ability to earn interst on trust accounts appears now to be universal, the relatively small amount of interest to be earned on nominal amounts and on larger amounts held in trust for only a short period of time still would not permit or warrant the separate accounting for such deposits which is required in order to calculate the amount of interest attributable to each individual client in such types of deposits. The committee concluded that interest which cannot be economically or practically identified or paid to specific clients should now be dedicated to various law-related and tax-exempt purposes rather than be foregone.

9. The committee further determined that participation in the program should be mandatory. The establishment of an interest bearing account for client trust funds is not an undue burden on practicing attorneys, and the benefits derived from statewide implementation of this plan far outweigh any slight inconvenience to attorneys. In the committee's judgment, a voluntary plan would require hundreds of attorney hours in attempting to persuade other attorneys to participate in the program. After study of Florida's voluntary program, the committee concluded that requiring such efforts would not be feasable.

10. The committee further determined that the lawyer, under a standard of ordinary prudence, should retain the discretion to determine whether particular client funds should be deposited in a pooled account or in a separate account accruing interest to be paid to the individual client. That is, the lawyer should have the discretion, using ordinary prudence, to determine at the outset, when the funds are received, as to what sums are either nominal in amount or larger in amount but to be kept for a short period of time, or when sums would generate sufficient interest as to warrant opening a separate savings account for a particular client.

11. The committee further determined that a new Lawyer Trust Account Board should be established and supervised by this Court for the purposes of receiving and disbursing for law-related tax-exempt public purposes the funds generated from the pooled interest bearing account under this proposed plan.

12. Accordingly, the committee submitted its unanimous recommendations to the Board of Governors of the Minnesota State Bar Association on March 27, 1982. With a minor amendment, the Board of Governors approved the recommendations and forwarded them for consideration by the MSBA Convention. Typical questions and answers pertaining to the proposed program were circulated to the delegates to the convention. (A copy of these questions and answers are attached hereto as "Exhibit B" and incorporated herein by reference.) On June 19, 1982, the General Assembly of the MSBA meeting in St. Paul approved the recommendation of the committee as approved by the Board of Governors and requested the Association to petition this Court to adopt the rule changes which follow in the prayer for relief herein.

WHEREFORE, PETITIONER RESPECTFULLY REQUESTS that this Court amend the Code of Professional Responsibility as applicable in the State of Minnesota as follows:

DR 9-102 PRESERVING IDENTITY OF FUNDS AND PROPERTY OF A CLIENT

(A) All funds of clients paid to a lawyer or law firm ~~other than advances for costs and expenses;~~ shall be deposited in one or more identifiable ~~bank~~ interest bearing trust accounts ~~maintained in the state in which the law office is situated~~ as set forth in DR 9-103. ~~and~~ No funds belonging to the lawyer or law firm shall be deposited therein except as follows:

(1) Funds of the lawyer or law firm reasonably sufficient to pay ~~bank~~ service charges may be deposited therein.

[BALANCE OF DR 9-102 UNCHANGED.]

DR 9-103 INTEREST BEARING TRUST ACCOUNTS

(A) Each trust account referred to in DR 9-102 shall be an interest bearing trust account in a bank, savings bank, trust company, savings and loan association, savings association, credit union, or federally regulated investment company selected by a lawyer in the exercise of ordinary prudence.

(B) A lawyer who receives client funds shall maintain a pooled interest bearing trust account for deposit of client funds that are nominal in amount or expected to be held for a short period of time. The interest accruing on this account shall be paid to the Lawyer Trust Account Board established by the Minnesota Supreme Court.

(C) All client funds shall be deposited in the account specified in subdivision (B) unless they are deposited in:

(1) A separate interest bearing trust account for the particular client or client's matter on which the interest, net of any transaction costs, will be paid to the client; or

(2) A pooled interest bearing trust account with subaccounting which will provide for computation of interest earned by each client's funds and the payment thereof, net of any transaction costs, to the client.

(D) In determining whether to use the account specified in subdivision (B) or an account specified in subdivision (C), a lawyer shall take into consideration the following factors:

(1) The amount of interest which the funds would earn during the period they are expected to be deposited;

(2) The cost of establishing and administering the account, including the cost of the lawyer's services; and

(3) The capability of financial institutions described in subdivision (A) to calculate and pay interest to individual clients.

DR 9-104 REQUIRED BOOKS AND RECORDS; REQUIRED CERTIFICATE

(A) Every lawyer engaged in private practice of law shall maintain or cause to be maintained on a current basis books and records sufficient to demonstrate income derived from, and expenses related to, his private practice of law, and to establish compliance with DR 9-102 and DR 9-103. The books and records shall be preserved for at least six years following the end of the taxable year to which they relate or, as to books and records relating to funds or property of clients, for at least six years after completion of the employment to which they relate.

(B) Every lawyer subject to DR 9-1034(A) shall certify, in connection with the annual renewal of his registration and in such form as the Clerk of the Supreme Court may prescribe that he

or his law firm maintains books and records as required by DR 9-103A(A).

PETITIONER FURTHER RESPECTFULLY REQUESTS that this Court create a new Lawyer Trust Account Board with rules as follows:

RULES ON LAWYER TRUST ACCOUNT BOARD

RULE 1. COMPOSITION

The Lawyer Trust Account Board shall consist of six lawyers having their principal offices in this state, three of whom the Minnesota State Bar Association may nominate, and three public members resident in this state, all appointed by this Court to three-year terms except that shorter terms shall be used where necessary to assure that one-third of all terms expire each February 1st. No person may serve more than two three-year terms, in addition to any initial shorter term.

RULE 2. POWERS AND DUTIES

(a) General. The Board shall have general supervisory authority over the administration of these Rules.

(b) Receipt and investment of funds. The Board shall receive funds from lawyers' interest bearing trust accounts and make appropriate temporary investments of such funds pending disbursement of them.

(c) Disbursement of funds. The Board shall, by grants and appropriations it deems appropriate, disburse funds for the tax exempt public purposes which the Board may prescribe from time to time consistent with Internal Revenue Code Regulations and rulings, including those under Section 501(c)(3).

(d) Records and reports. The Board shall maintain adequate books and records reflecting all transactions, shall report quarterly to the Court, and shall report annually to the Minnesota State Bar Association and to the public.

RULE 3. OFFICERS

(a) Chairperson. The Board shall select a Board member to serve as Chairperson at the pleasure of the Board.

(b) Other officers. The Board may elect other officers as it deems appropriate and may specify their duties.

RULE 4. DIRECTOR

(a) Appointment. The Board may appoint an Executive Director to serve on a full or part time basis at the pleasure of the Board and to be paid such compensation as the Board shall fix.

(b) Duties. The Director shall be responsible and accountable to the Board for the proper administration of these Rules.

(c) Services. The Director may employ persons or contract for services as the Board may approve.

RULE 5. COMPENSATION AND EXPENSES

The Chairperson and other members of the Board shall serve without compensation but shall be paid their reasonable and necessary expenses incurred in the performance of their duties. All expenses of the operation of the Board shall be paid from funds the Board receives from lawyers' interest bearing trust accounts.

RULE 6. DISPOSITION OF FUNDS UPON DISSOLUTION

If the Lawyer Trust Account Board is discontinued, any funds then on hand shall be transferred to its successor state agency or organization qualifying under Internal Revenue Code section 501(c)(3), if any, for distribution for the purposes specified under Rule 2 or, if there is no successor, to the general fund of the State of Minnesota.

RULE 7. SUPPLEMENTAL RULES

The Board may make and adopt rules not inconsistent with these Rules to govern the conduct of its business and performance of its duties.

PETITIONER FURTHER RESPECTFULLY REQUESTS that this Court set down a time for hearing on the proposals contained in this petition.

DATED: June 30, 1982

MINNESOTA STATE BAR ASSOCIATION,
A NON-PROFIT CORPORATION

BY: Clinton A. Schroeder
Clinton A. Schroeder, President

BY: Allen I. Saeks
Its Committee on Interest on Lawyers' Trust Accounts
Allen I. Saeks, Chairman

Attachments: EXHIBIT A
Annual Report of the Committee on Interest on Lawyers' Trust Accounts

EXHIBIT B
INTEREST ON TRUST ACCOUNTS: Some Questions and Answers

"EXHIBIT A"

FINAL REPORT
APPROVED BY BOARD OF GOVERNORS
MARCH 27, 1982

NO RECOMMENDATION PRESENTED HEREIN REPRESENTS THE POLICY OF THE MINNESOTA STATE BAR ASSOCIATION UNTIL IT SHALL HAVE BEEN APPROVED BY THE ASSEMBLY, THE HOUSE OF DELEGATES, OR THE BOARD OF GOVERNORS. INFORMATIONAL REPORTS, COMMENTS AND SUPPORTING DATA ARE NOT APPROVED BY THEIR ACCEPTANCE FOR FILING AND DO NOT BECOME A POLICY OF THE MINNESOTA STATE BAR ASSOCATION UNLESS SPECIFICALLY APPROVED BY THE GENERAL ASSEMBLY, THE HOUSE OF DELEGATES, OR THE BOARD OF GOVERNORS.

COMMITTEE ON INTEREST ON LAWYERS' TRUST ACCOUNTS

RECOMMENDATIONS

1. That the Minnesota State Bar Association petition the Minnesota Supreme Court to amend portions of the Code of Professional Responsibility as set forth in Appendix A to require the deposit of all client funds in interest-bearing trust accounts, and to require that all attorneys maintain an interest-bearing trust account for funds of nominal amount or to be on deposit for short periods of time with the interest thereon to be used for law-related, tax-exempt public purposes.

2. That the Minnesota State Bar Association petition the Minnesota Supreme Court to establish the Lawyer Trust Account Board to operate under the Rules set forth in Appendix B, and under the Court's supervision, to receive, administer and disburse interest on such trust account funds for law-related charitable and educational purposes.

REPORT

This Committee was appointed by the Board of Governors:

> To monitor continuing developments among bar associations, the banking industry, the judicial system, and the Federal government regarding the use of interest earned on lawyers' trust accounts.

To analyze and make recommendations to the Board of Governors on any use of such interest by the organized bar and the method of implementation of any such uses.

Recommendations should be made within this membership year.

The Committee appointed by the Board of Governors was chaired by Allen I. Saeks, a Minneapolis attorney and included eight other attorneys, a diverse cross-section of the Minnesota Bar, and three non-attorney members, including the President of the Twin Cities Citizens League, an active volunteer in widely-based community organizations and an elementary school principal. The Committee met eight times during the year in Minneapolis. All the active members of the Committee join in this Report and in the recommendations made herein.

The primary thrust of the Committee's work was to review various developments in the use of interest on attorneys' trust account funds in other states, and to evaluate the desirability and feasibility of implementing some program for use of interest on trust account funds in Minnesota.

Historical Background

Under the Minnesota Code of Professional Responsibility, funds of clients entrusted to the lawyer must be deposited in a separate bank account. DR 9-102. As a matter of practice, and for various reasons, trust accounts traditionally have not borne interest. The non-interest bearing nature of these types of accounts is commonly found throughout the United States. Programs similar to the proposal made by the Committee have been implemented successfully in the Canadian Provinces and the Australian States.

Motivated by the escalation of interest rates in recent years, by the increased flexibility in the types of accounts available in financial institutions, and by other factors, bar associations have turned their attention to capturing the interest currently being lost on trust accounts for use either directly by clients, or for charitable purposes benefiting the public as a whole.

In 1976 the Florida Bar Association petitioned the Florida Supreme Court to adopt a program to permit interest to be earned on lawyers' trust accounts. Following a series of hearings and revisions to that original petition, the Florida Supreme Court finally approved such a program in July of 1976. The history of the Florida program is set forth in England & Carlisle, History of Interest on Trust Accounts Program, 1982 Florida Bar Journal 101 (FEB. 1982). The Florida program calls for attorneys to participate voluntarily by setting up an interest-bearing trust account, the interest from which is automatically turned over to the Florida Bar Foundation. This system has received the approval of the Board of Governors of the Federal Reserve System, and a formal IRS Revenue Ruling was sought and obtained to prevent the taxation of the interest generated in this program to the clients. The interest-bearing account is designed to be used only for trust funds which are "nominal in amount and to be held for a short duration." The Florida program does not address the question of how to treat the interest on other trust funds. Presumably, those funds would either continue to be held in a non-interest bearing

account or in a special interest-bearing account upon which the interest would be paid over to the client.

The Florida program, which is voluntary, has had limited impact to date. The Florida Bar has been engaged in an extensive program of telephone and personal solicitation of attorney participation. This solicitation campaign, not unlike Minnesota's efforts to capitalize Minnesota Lawyers Mutual, has, so far, not even resulted in 10% attorney participation. The costs of this type of voluntary program in attorney time and actual dollars spent would appear to approach or exceed the interest generated to date on the trust accounts.

California has also adopted a program for capturing interest on lawyers' trust accounts. The California approach differs from the Florida program in a number of ways. First, the California program was adopted legislatively rather than judicially. Second, it is a mandatory program. Third, the legislation requires attorneys either (1) to place funds in a separate interest-bearing account, with the interest payable to the client, or (2) to use a pooled interest-bearing account, with the interest payable to the California State Bar for certain listed purposes. The California legislation became effective January 1, 1982. Reports on the functioning of this new plan are not as yet available.

The legislation provides that the interest be used for distribution to qualified legal service programs and support centers based upon a formula which attempts to prorate the funds to counties on the basis of the number of poor people in each county.

Other states as well are exploring various methods of using interest on idle funds in lawyers' trust accounts through a variety of formal and informal committees. The American Bar Association has appointed a Task Force which is monitoring progress in the various states and assisting efforts to implement programs such as the program proposed by this Committee.

Desirability of Recovery of Interest

The conditions affecting the practicality of earning interest on client trust funds have changed radically in recent years. In 1980, Congress enacted legislation which permitted the use of Negotiable Order of Withdrawals (NOW) accounts. NOW accounts are interest-bearing accounts subject to withdrawal on demand. Under earlier banking legislation, interest could only be earned on savings accounts which were not technically subject to withdrawal on demand. Although subject to restrictions discussed below, the potential availability of NOW accounts for lawyers' trust accounts may perhaps remove the greatest obstacle to earning interest on such trust accounts.

A second problem has been the relatively high administrative costs of calculating and paying interest on trust accounts. Computer technology and increasing competition in the financial services industry, however, have combined to make possible subaccounting of a type that can economically compute interest on a large number of accounts for funds which are held for short periods of time. Although such capability is not now widely available, it is offered by some institutions. The committee expects that the continuing revolution in the financial services industry and the ever increasing utilization of computer technology within that industry may lead to a future in which such sub-accounting services are more widely available than they are today.

Recent years have also seen escalating interest rates. High interest rates have the effect of making the "lost" interest on idle trust funds a matter of greater concern and of tending to raise the level of administrative effort which is justified by the income potential which such funds hold.

The committee believes that the combination of the foregoing factors makes a compelling case for changing the manner of dealing with trust funds. The time has come to end the almost universal practice of placing client funds in non-interest bearing accounts and to require all client funds to earn interest, either for the client's benefit or for law-related charitable and educational purposes. The committee believes that this change is warranted notwithstanding that lawyers are not in the business of investment management and are not expected to maximize the rate of return on client funds which they hold for other specific purposes.

The factors set forth above would not necessarily lead to the committee's recommendation that earnings on lawyer trust accounts be committed to certain charitable purposes. However, two additional factors lead the committee to this facet of its conclusions. First, although the ability to earn interest on trust accounts appears now to be universal, the committee believes that the amount of interest to be earned on many deposits of clients held in trust still would not warrant the separate accounting for such deposits which is required to calculate the amount of interest earned by the particular client. Obviously the threshhold at which this conclusion no longer has validity will vary depending upon the interest rate, the amount of the funds, the duration for which they are expected to be held and the cost and availability of the services to calculate interest on each individual deposit, as well as the cost of the lawyer's time in administering the separate account. While the availability of such services from the financial services industry may increase in the future and cause an increase in the percentage of instances in which it is practicable to earn and pay interest to clients, the reality today is that, for a very significant portion of lawyers' trust funds, the cost of making such calculations would exceed the interest to be earned. Accordingly, although interest now can be earned, it is clear that it cannot practicably always be credited and paid to clients.

Second, the fundamental principle of equal justice for all requires substantial efforts on a variety of fronts, which efforts cost money. The problems that are perhaps most in the public consciousness today are the problems of delivery of legal services to the poor. Efforts which were thought by many to be inadequate in the first place are being substantially reduced by cutbacks in federal aid. The committee believes that there will always be need for funds to pursue this important goal, whether for funding legal services for the poor, widely considered to be a major need today, or for other law related public purposes.

The committee believes that these additional factors make a compelling case for the requirement that the interest on lawyers' trust funds which is not (for whatever reason) computed client by client, should be directed toward law-related public purposes. The vehicle which the committee recommends for accomplishing this goal is the Lawyer Trust Account Board to be established by the Minnesota Supreme Court as outlined in Appendix B.

The committee finds the practicality and the desirability of earning iterest on lawyers trust accounts to be so compelling as to warrant a break with tradition by moving to a requirement that lawyers' trust accounts be interest-bearing.

Barriers to Recovery of Interest

There are many reasons which explain the now prevalent practice of not recovering interest on clients' trust funds, which are normally held in checking accounts. One of the most important reasons for using a non-interest bearing account is the problem of income taxation of the interest generated on an interest-bearing account. Under the so-called "assignment of income" doctrine and rules of the Internal Revenue Service, if the client exercises any control over the trust funds, the interest generated on the funds "belongs to the client" and is taxable income to the client. If an attorney were to deposit client funds in an interest-bearing account which pooled the funds of more than one client, that attorney would have the burden of allocating the interest earned on the account to each client, respectively, and reporting the accrual of that interest to the IRS on the appropriate forms provided for that purpose for each client.

The practical availability of interest-bearing accounts for trust funds was enhanced by Congressional action in 1980 which permitted the use of Negotiable Order of Withdrawal (NOW) accounts. NOW accounts are interest-bearing accounts subject to withdrawal on demand. Under earlier banking legislation, interest could only be earned on savings accounts which were not technically subject to withdrawal on demand. The legislation permitting NOW accounts, however, does not allow such accounts to be opened by corporations or partnerships, but only by individuals or non-profit organizations.

The Florida Bar Association received an opinion from the Board of Governors of the Federal Reserve Bank which approved the use of NOW accounts for the pooled interest funds under the Florida Bar program even if the funds relate to a corporate client because the only entity actually having any beneficial ownership of the interest in such corporate accounts would be the Florida Bar Foundation, a non-profit corporation. The Florida Attorney General had previously rendered an opinion that the beneficial interest in the proceeds of the account lay solely in the Florida Bar Foundation and not with clients, whatever their legal form of organization might be.

A Program for Minnesota

The Committee carefully reviewed each feature of existing and proposed plans in other states, and now recommends a proposal which it believes is most suitable for Minnesota's needs. The Committee recommends that the Minnesota State Bar Association petition the Minnesota Supreme Court to revise the provisions of the existing Code of Professional Responsibility adopted by it in 1969 pertaining to lawyers' trust accounts, and to continue to exercise ultimate supervision over the collection and use of interest accruing on funds in attorneys' trust accounts. The Committee also recommends that the MSBA petition the Minnesota Supreme Court to create a Board under the Court's supervision to effectuate this purpose.

The Committee's specific proposals are set forth in the attached proposed Amendments to the Code of Professional Responsibility and Proposed Rules on Lawyer Trust Account Board, Appendixes A and B. The most important features of these proposed amendments are:

1. Interest On All Trust Funds. Require each lawyer to deposit any client funds into interest-bearing accounts, because there is no sound reason for permitting client trust funds to lie idle and be wholly unproductive.

2. Mandatory Pooled Interest-Bearing Account For Charitable and Educational Purposes. Require that client funds nominal in amount or to be on deposit only for a short period of time be placed in a pooled interest-bearing account. The Committee considered the advantages and disadvantages of a mandatory program -- as opposed to a voluntary program such as in Florida -- and determined that a mandatory program was most desirable. The establishment of a pooled interest-bearing account for client trust funds is not an undue burden on practicing attorneys, and the benefits derived from state-wide implementation of this plan far outweigh any slight inconvenience to attorneys.

3. Lawyers Retain Discretion. The lawyers would retain the discretion to determine whether funds should be deposited in the pooled public purpose account or in an account paying interest to the individual client. The considerations set forth in proposed DR9-103(D) provide guidance as to the factors which should be considered by the lawyer in making this decision.

4. Use For Law-Related Educational and Charitable Purposes. Establish a means to use the interest on pooled trust funds (those nominal in amount or to be held for a short duration) for law-related charitable and educational purposes, such as legal services for the poor, programs for the education of children and other members of the public about the law, as well as other law-related public purposes which may be prescribed by the Lawyer Trust Account Board consistent with Internal Revenue Code §501(c)(3).

5. Establish a Lawyer Trust Account Board. Establish a Board of six lawyers and three nonlawyers appointed by the Supreme Court to receive the interest generated on the pooled trust funds and to disburse those funds by grants and appropriations for the above purposes. Of the six lawyer members, three would be nominated by the Minnesota State Bar Association.

Estimate of Funds to Be Generated

The Committee conducted an informal, admittedly unscientific survey of 25 practicing Minnesota attorneys in an attempt to determine the average balances in trust accounts now maintained. These attorneys were selected from all geographic areas of the state, and an attempt was made to include those practicing with firms of every size and type of practice. Of the 25 firms solicited, 14 (representing 267 lawyers) returned responses to the questionnaires. These responses suggest an average balance in trust accounts at any given time of approximately $2,000 per attorney. Based on the estimate that 11,000 attorneys are presently licensed to practice law in Minnesota, and assuming that 60% are engaged in the private practice of law, an estimate of total trust fund balances at any one time would be in excess of $13 million. That would mean that nearly $700,000 in interest is currently not being earned annually, even assuming a modest 5-1/4% interest rate.

Further Action if Approval Given

It is recommended that, should the MSBA approve the recommendations of this Committee, a committee should be authorized to assist in drafting a petition to the

Minnesota Supreme Court, and to obtain any necessary approvals of administrative agencies, including possibly the Minnesota Attorney General, Minnesota Department of Revenue, Internal Revenue Service or Federal Reserve System, and to assist in the implementation of the plan.

Committee Vote

This Report and these Recommendations have received the unanimous approval of this Committee.

By 

Allen I. Saeks, Esq., Chairman
Minneapolis

Mr. Boyd L. Berg
Minneapolis

Ms. Pat Davies
Minneapolis

David F. Herr, Esq.
Minneapolis

John P. James, Esq.
Minneapolis

Ms. Kris Johnson
Minneapolis

Prof. Kenneth F. Kirwin
Saint Paul

A. Patrick Leighton, Esq.
Saint Paul

Rita E. Lukes, Esq.
Minneapolis

David F. Lundeen, Esq.
Fergus Falls

Gerald E. Magnuson, Esq.
Minneapolis

Donald L. Maland, Esq.
Montevideo

APPENDIX A

DR 9-102 PRESERVING IDENTITY OF FUNDS AND PROPERTY OF A CLIENT

(A) All funds of clients paid to a lawyer or law firm ~~other than advances for costs and expenses,~~ shall be deposited in one or more identifiable ~~bank~~ interest bearing trust accounts ~~maintained in the state in which the law office is situated~~ as set forth in DR 9-103. ~~and~~ No funds belonging to the lawyer or law firm shall be deposited therein except as follows:

(1) Funds of the lawyer or law firm reasonably sufficient to pay ~~bank~~ service charges may be deposited therein.

[BALANCE OF DR 9-102 UNCHANGED.]

DR 9-103 INTEREST BEARING TRUST ACCOUNTS

(A) Each trust account referred to in DR 9-102 shall be an interest bearing trust account in a bank, savings bank, trust company, savings and loan association, savings association, credit union, or federally regulated investment company selected by a lawyer in the exercise of ordinary prudence.

(B) A lawyer who receives client funds shall maintain a pooled interest bearing trust account for deposit of client funds that are nominal in amount or expected to be held for a short period of time. The interest accruing on this account shall be paid to the Lawyer Trust Account Board established by the Minnesota Supreme Court.

(C) All client funds shall be deposited in the account specified in subdivision (B) unless they are deposited in:

(1) A separate interest bearing trust account for the particular client or client's matter on which the interest, net of any transaction costs, will be paid to the client; or

(2) A pooled interest bearing trust account with subaccounting which will provide for computation of interest earned by each client's funds and the payment thereof, net of any transaction costs, to the client.

(D) In determining whether to use the account specified in subdivision (B) or an account specified in subdivision (C), a lawyer shall take into consideration the following factors:

(1) The amount of interest which the funds would earn during the period they are expected to be deposited;

(2) The cost of establishing and administering the account, including the cost of the lawyer's services; and

(3) The capability of financial institutions described in subdivision (A) to calculate and pay interest to individual clients.

DR 9-104 REQUIRED BOOKS AND RECORDS; REQUIRED CERTIFICATE

(A) Every lawyer engaged in private practice of law shall maintain or cause to be maintained on a current basis books and records sufficient to demonstrate income derived from, and expenses related to, his private practice of law, and to establish compliance with DR 9-102 and DR 9-103. The books and records shall be preserved for at least six years following the end of the taxable year to which they relate or, as to books and records relating to funds or property of clients, for at least six years after completion of the employment to which they relate.

(B) Every lawyer subject to DR 9-103(A) shall certify, in connection with the annual renewal of his registration and in such form as the Clerk of the Supreme Court may prescribe that he or his law firm maintains books and records as required by DR 9-103(A).

APPENDIX B

RULES ON LAWYER TRUST ACCOUNT BOARD

RULE 1. COMPOSITION

The Lawyer Trust Account Board shall consist of six lawyers having their principal offices in this state, three of whom the Minnesota State Bar Association may nominate, and three public members resident in this state, all appointed by this Court to three-year terms except that shorter terms shall be used where necessary to assure that one-third of all terms expire each February 1st. No person may serve more than two three-year terms, in addition to any initial shorter term.

RULE 2. POWERS AND DUTIES

(a) General. The Board shall have general supervisory authority over the administration of these Rules.

(b) Receipt and investment of funds. The Board shall receive funds from lawyers' interest bearing trust accounts and make appropriate temporary investments of such funds pending disbursement of them.

(c) Disbursement of funds. The Board shall, by grants and appropriations it deems appropriate, disburse funds for the tax exempt public purposes which the Board may prescribe from time to time consistent with Internal Revenue Code regulations and rulings, including those under Section 501(c)(3).

(d) Records and reports. The Board shall maintain adequate books and records reflecting all transactions, shall report quarterly to the Court, and shall report annually to the Minnesota State Bar Association and to the public.

RULE 3. OFFICERS

(a) Chairperson. The Board shall select a Board member to serve as Chairperson at the pleasure of the Board.

(b) Other officers. The Board may elect other officers as it deems appropriate and may specify their duties.

RULE 4. DIRECTOR

(a) Appointment. The Board may appoint an Executive Director to serve on a full or part time basis at the pleasure of the Board and to be paid such compensation as the Board shall fix.

(b) Duties. The Director shall be responsible and accountable to the Board for the proper administration of these Rules.

(c) Services. The Director may employ persons or contract for services as the Board may approve.

RULE 5. COMPENSATION AND EXPENSES

The Chairperson and other members of the Board shall serve without compensation but shall be paid their reasonable and necessary expenses incurred in the performance of their duties. All expenses of the operation of the Board shall be paid from funds the Board receives from lawyers' interest bearing trust accounts.

RULE 6. DISPOSITION OF FUNDS UPON DISSOLUTION

If the Lawyer Trust Account Board is discontinued, any funds then on hand shall be transferred to its successor state agency or organization qualifying under Internal Revenue Code section 501(c)(3), if any, for distribution for the purposes specified under Rule 2 or, if there is no successor, to the general fund of the State of Minnesota.

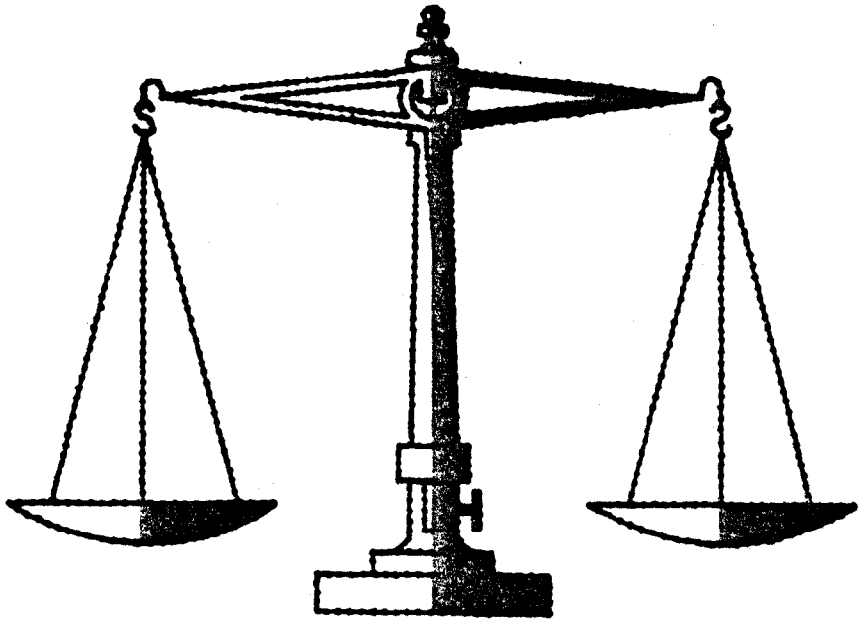
RULE 7. SUPPLEMENTAL RULES

The Board may make and adopt rules not inconsistent with these Rules to govern the conduct of its business and performance of its duties.

"EXHIBIT B"

INTEREST ON TRUST ACCOUNTS—

SOME QUESTIONS AND ANSWERS



Q. What would the interest on trust accounts program do?

A. The program would require attorneys to deposit certain trust funds so that they generate interest payable to a Lawyer Trust Account Board established by the Minnesota Supreme Court for use in law-related public service programs. Under present practice, these funds do not generate interest, so only the financial institutions in which they are deposited benefit from the earning power of such funds.

The proposed program only makes use of interest from client trust deposits so short in duration or small in amount that the interest on any single client's deposit could not be made available to that client as a practical matter. To the extent that interest on a client's deposit can feasibly be made available for the benefit of that client, the program does not alter longstanding trust accounting practices which acknowledge that fiduciary option. Client deposits expected to be of short duration or nominal amount would be pooled by the attorney and the interest earned would be forwarded to the new Lawyer Trust Account Board.

Q. Why is the program needed?

A. Client deposits small in amount or short in duration have comprised a substantial sum of money on deposit, interest-free, in financial institutions. Those funds are now available to generate interest money that can be directed into programs for the benefit of society in general.

The charitable Lawyer Trust Account Board "would distribute the interest in keeping with program goals such as, e.g., to provide legal aid to the poor, to provide law-related education, and to promote such other programs for the benefit of the public as are specifically approved from time to time by the Lawyer Trust Account Board.

This opportunity for public service by Minnesota lawyers is especially appropriate due to the legal profession's enhanced awareness of its social obligations and due to reductions in the funding for various legal services programs.

Q. Do any other jurisdictions have such a program?

A. Yes. The use of such programs has been growing. They have been pioneered in British and Canadian jurisdictions, of which nearly 20 now have such programs.

The success of such programs in other jurisdictions, coupled with changes in American banking rules which have reduced the practical and legal problems in generating earnings on attorney trust accounts have generated considerable interest in such programs around the United States. A number of states have such a program under consideration and three--Florida, California and Maryland--have adopted programs for earning interest on lawyers' trust accounts.

Q. How does the program affect trust fund practices?

A. This program imposes no new decisional burden upon attorneys. Since time immemorial, lawyers have soundly exercised their discretion in determining whether a given client's trust deposit was of sufficient size or duration to justify placement in a spearate interest-bearing investment, with the interest payable to the client. Under the proposed program, attorneys will retain their discretion and continue to make these fiduciary decisions. The terms "nominal" and "short period of time" in the proposal merely reflect this time-honored standard.

Similarly, the program imposes no new administrative burden on attorneys. The duty to offer separate, interest-bearing accounts to clients whose deposits are neither nominal in amount nor to be held for a short period of time is not expanded or changed by this program. An attorney would continue to place nominal or short-term deposits into a single, unsegregated account. The only change caused by the program is that this account would now bear interest. This change should not affect how an attorney or a law firm handles client deposits.

In addition, the proposed program makes it clear that for clients whose deposits are neither nominal in amount nor to be held for a short period of time, the deposits would be made in separate interest bearing accounts for the benefit of the client.

Q. How would lawyers work with financial institutions?

A. Financial institutions--not attorneys--would be responsible for transmitting interest income and furnishing at least quarterly interest reports to the Lawyer Trust Account Board. The proposal provides that the funds generated would absorb any financial institution's special charges or fees for participation in the program, by directing that interest payments be net of such charges and fees.

Interest remittances to the Board would be made either by bank check via Untied States mail or through a clearing/ correspondent banking network directly to the Board's account. Interest remittances sent to the Board would reflect the lawyer/ law firm in whose name the money was sent and the rate of interest applicable to that payment.

With each remittance, the participating lawyer would be advised of the amount paid to the Lawyer Trust Account Board, the applicable interest rate and the average account balance during the time period for which the report was made.

Bar officials would undertake an active educational campaign to familiarize the Minnesota financial community with the program and to encourage its cooperation in supporting the program goals. Full cooperation from all financial institutions is expected in this interprofessional endeavor. It is anticipated that this implementation program and competitive marketplace conditions will also promote acceptance within the financial community.

Q. What types of financial institutions would participate in the program?

A. To the extent feasible, the proposal contemplates that a variety of different kinds of financial institutions would participate, including commercial banks, savings and loan associations, credit unions and federally regulated money market funds. Attorneys would, in the exercise of ordinary prudence, determine in which participating institution to deposit the pooled funds generated from their own offices.

Q. What are an attorney's ethical obligations under the program?

A. As has always been trust accounting practice, absolutely no trust funds or earnings from trust funds may be made available to any attorney or law firm.

Earnings will be made available to the client on deposited funds which are neither nominal in amount nor to be held for short periods of time. Such sums would be invested by attorneys in an interest-bearing medium for the client's benefit, with full disclosure.

However, no charge of ethical impropriety or professional misconduct would attend a good-faith, reasonable determination by the lawyer <u>at the outset</u> that a particular sum was nominal in amount or expected to be held only for a short period of time.

Q. Does the interest on trust accounts program deprive clients of their money?

A. No. The interest on trust accounts program was not meant to utilize interest generated from all client trust deposits--only those nominal in amount or expected to be held for short periods of time. In those situations no client is deprived of any practicable income opportunity, as evidenced by current trust accounting practices whereby nominal and short-term deposits are placed in non-interest-bearing accounts. If these deposits were placed in separate interest-generating accounts, the administrative costs, including fees for the attorneys' services, coupled with the resulting income tax liability to the client, would more than offset any income earned.

Q. Must clients be notified of a lawyer's participation in the program?

A. It is possible that the Minnesota Supreme Court's enabling opinion would state that notification to clients whose funds are nominal in amount or to be held for a short period of time will be unnecessary. However, any discussions with the client would continue to include those matters traditionally raised when a lawyer exercises professional judgment in determining whether or not a client deposit is of sufficient size or duration to justify placement in an interest-bearing account, with interest payable to the client.

However, regardless of the language in any Minnesota Supreme Court enabling decision, an attorney may want to notify clients of the program in some fashion. There should be no impropriety in an attorney or law firm advising all clients of the lawyers' willingness to advance the administration of justice in Minnesota beyond their individual abilities by participating in the proposed program.

Q. What are the tax consequences of participation in the program?

A. The Internal Revenue Service has stated in Revenue Ruling 81-209 that the interest earned on nominal and short-term client advances which is paid over to a bar foundation pursuant to a court-established interest on trust accounts program is not includable in the gross income of the clients.

While the proposed program is couched in terms of client funds "nominal in amount or to be held for a short period of time," tax counsel in at least one other state has opined that such a program should not produce income taxable to clients. Interest earned on client funds which are either small in amount or expected to be on deposit for a short period of time is not expected to be includable in the gross income of the client. Similarly, because the interest generated under the program is to be paid over to a state board which will expend the funds for charitable and educational purposes, there should be no income tax consequences to any entity or person.

Q. Who will decide where the monies generated under the program will go and for what purposes will the money be expended?

A. The Lawyer Trust Account Board will determine how the monies received will be allocated. The Board, comprised of 6 lawyers and 3 non-lawyers appointed by the Supreme Court, would consider applications for funds from qualified charitable, law-related organizations. The MSBA committee responsible for the proposal contemplates that the monies will be allocated to such purposes as legal assistance to the poor, law-related education and other law-related public purposes consistent with provisions of the Internal Revenue Code, and that the funds will be available for allocation throughout the state.

Q. What will happen next if the delegates at the Bar convention approve the proposed program?

A. It is contemplated that the MSBA would petition the Minnesota Supreme Court to amend the Code of Professional Responsibility so as to make the proposal operative, and to establish the Trust Account Board. The Court would undoubtedly hold a hearing on the proposals at which attorneys as well as members of the public could be heard. Before the program became operational the MSBA would work with Minnesota financial institutions to ensure that participation in the program would be conveniently available to attorneys throughout the state and would undertake an educational campaign to inform attorney of the program as finally adopted.