

## The Dishonored Check Reporting Rule - Year 2001 Update

New York's Dishonored Check Reporting Rule<sup>1</sup> has proven to be an effective detection device of the misuse of client funds.

The New York Lawyers' Fund for Client Protection is a state agency financed by the legal profession to reimburse law clients for the theft of their money in the practice of law in New York State. The Fund is financed by a \$60 share of the \$300 biennial registration fee.<sup>2</sup> Annually, the Fund reimburses approximately \$8 million for losses caused by dishonest conduct in the practice of law. The vast majority of these losses involve the misuse of law firm trust and escrow accounts in the practice of law.

The Fund is administered by a seven-member Board of Trustees, five lawyers, and two non-lawyers, who serve *pro bono publico* and without compensation. With insight derived from the evaluation of claims for reimbursement, the Trustees are able to identify deficiencies in legal practice, and often recommend changes to judicial and bar leaders to resolve those deficiencies. The Trustees' goal is to reduce the opportunity for the abuse of trust by dishonest lawyers.

An example of this is found in New York's Dishonored Check Reporting Rule program which became effective on January 1, 1993. The Dishonored Check Reporting Rule was adopted as a joint rule of the Appellate Divisions and was first heralded in the New York Law Journal in November 1992.<sup>3</sup> The New York Lawyers' Fund administers this court program, at no cost, and serves as a clearinghouse for items reported under the rule.

From January 1993 through December 2001, the Lawyers' Fund has processed nearly 8,000 bounced check reports on attorney trust, special or escrow accounts. Of that number, more than 3,900 reports have been forwarded to attorney grievance committees statewide as required under the rule.

The face amount of all notices received by the Fund through December 2001 exceeds \$90 million. In administering the program, the Fund has "weeded out" over 4,000 reports sent in error as not involving reportable accounts. Cumulatively, notices forwarded to the Fund have involved over 2,700 lawyers or law firms in New York State.

What is most remarkable is the fact that over 86 attorneys have been detected and apprehended for the misuse of client funds as a direct result of the bounced check program. Since 1993, the Fund has approved 280 awards of reimbursement totaling over \$5 million which

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<sup>1</sup>22 NYCRR Part 1300.1

<sup>2</sup>See, NY Judiciary Law §468-b, NY State Finance Law §97-t, 22 NYCRR Parts 7200 *et seq.*

<sup>3</sup>See, Alter, Eleanor Breitel, *Coming Jan. 1: The Dishonored Check Notice Rule* (NYLJ, Thursday, November 19, 1992, OUTSIDE COUNSEL: Page 1).

has involved 47 dishonest attorneys detected by the “bounced check rule”.<sup>4</sup>

While these numbers may seem large, one must consider what the potential impact on the Fund and the public would have been but-for the existence and early detection element provided by the bounced check rule.

Since 1993, the Fund’s procedures have remained relatively unchanged. Court rules require lawyers and law firms to use one of three designations for their client funds accounts: Attorney Special; Attorney Trust or Attorney Escrow Account.<sup>5</sup> IOLA bank accounts are included, as are bank accounts that are maintained by lawyers in out-of-state banks with the prior written permission of their clients.

Lawyers are only permitted to maintain these accounts with banks which have agreed to report trust account checks that have been dishonored for insufficient funds, or true “bounced” checks, to the New York Lawyers’ Fund.<sup>6</sup> Lawyers and law firms are also obligated under the rule to promptly notify their banks of existing client and escrow accounts, as well as when they establish new accounts.<sup>7</sup>

For purposes of the rule, a banking institution is defined as a "state or national bank, trust company, savings bank, savings and loan association or credit union."<sup>8</sup> Nearly all banks in New York State have voluntarily agreed to participate in this program. Since 1993, over 210 institutions have signed on. A current list of approved banking institutions is maintained by the Lawyers’ Fund and is also published on the Fund’s website under the Ethics and Escrow Materials section at [www.nylawfund.org/escrow.htm](http://www.nylawfund.org/escrow.htm).

Should an attorney bounce a trust account check, the participating banking institution is required to forward a copy of the notice to the Lawyers’ Fund within five banking days.<sup>9</sup> The Fund records the notice and holds it for a period of ten business days to permit the bank to withdraw an item that was generated by bank error.<sup>10</sup> A subsequent deposit or “cure” of the deficiency by the attorney or the law firm is not sufficient to withdraw an item that has been properly reported. At the end of ten business days, if the notice has not been withdrawn, it is

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<sup>4</sup>2001 Annual Report, New York State Lawyers’ Fund for Client Protection.

<sup>5</sup>22 NYCRR 1200.46 (b)(1), (2)

<sup>6</sup>22 NYCRR 1300.1 (a)

<sup>7</sup>22 NYCRR 1200.46 (b)(2)

<sup>8</sup>Ibid.

<sup>9</sup>22 NYCRR 1300.1 (e)

<sup>10</sup>22 NYCRR 1300.1 (f)

forwarded to the appropriate attorney grievance committee for investigation. The address of the account holder is the basis for determining which grievance committee has jurisdiction and receives the notice.<sup>11</sup>

Once a notice is forwarded, the Fund's file is closed and all further inquiries are directed to the attorney grievance committee. Generally, an attorney grievance committee will contact the attorney or law firm and request a written explanation for the dishonored item as well as six-months' bank records for the escrow account in question.

Since 1993, the Lawyers' Fund has conducted biennial surveys of the statewide attorney grievance committees asking each to share their experience of the Dishonored Check Reporting Rule in order to measure and evaluate the rule's success. The results are impressive.

As anticipated, most reports result from deficiencies in law office banking practices, not dishonest conduct. In these cases, the rule has served the function of identifying those deficiencies, and alerting practitioners to the accounting, banking and recordkeeping requirements of the Lawyer's Code of Professional Responsibility. Not surprisingly, attorney grievance committees have found the vast majority of lawyers in New York are in substantial compliance with trust account and recordkeeping rules.

Attorney grievance committees have also identified real estate practice as the area which generates the highest percentage of bounced check reports, often as the result of lawyers who have drawn checks against uncollected funds in commercial and residential realty closings.

Presently, twenty-five states have enacted some form of overdraft notification on attorney trust accounts.<sup>12</sup> Given New York's more limited rule, involving only insufficient funds notices, our results in only an eight-year period have been truly remarkable.

The encouraging news is with the advent of Mandatory Continuing Legal Education and continued improvements in the banking industry, practitioners are becoming better educated on their fiduciary obligations regarding client escrow funds. The New York Lawyers' Fund will continue to do its part in administering the Dishonored Check Notice Rule program. We are confident that the program will also continue to serve as a catalyst for educating the bar on proper trust accounting and record keeping procedures as well as an effective detection device for the misuse of law client funds in the practice of law.

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<sup>11</sup>22 NYCRR 1300.1(g)

<sup>12</sup> See, 1998 ABA Survey on Lawyers' Funds for Client Protection.