

## OPINION 2006-4

### Synopsis

All funds provided to an attorney in connection with a real estate closing must be maintained in a pooled interest bearing trust account unless the funds can reasonably be expected to generate substantial interest for a client. All trust accounts maintained by attorneys practicing in Vermont must be “overdraft notification accounts” as specified in Vermont Rules of Professional Conduct 1.15C.

### Question

The question posed is whether a law firm or title company operated by attorneys may establish a “closing account” separate from the client trust account for the purpose of collecting and disbursing funds for real estate closings. If the first question is answered in the affirmative, a supplemental question is provided as to whether the accounts must be IOLTA accounts and include the overdraft notification provisions set out in Rule 1.15C of the Vermont Rules of Professional Conduct (“VRPC”).

### Discussion

The applicable Rules are VRPC 1.15, 1.15B and 1.15C and are set out at length here:

#### **Rule 1.15. Safekeeping Property**

- (a) 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 accordance with Rules 1.15A, B and C. 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 six years after termination of the representation. (emphasis added).

#### **Rule 1.15B. Pooled Interest-Bearing Trust Accounts**

- (a) A lawyer or law firm which receives client funds shall create and maintain a pooled interest-bearing trust account for deposit of client funds that are not reasonably expected to earn a substantial amount of interest for the client, individually or in combination with other client funds held by the lawyer or law firm. No earnings of the account shall be made available to the lawyer or law firm. The interest accruing on this account, net of any transaction costs, shall be paid over to the Vermont Bar Foundation. No lawyer may be disciplined for placing client funds in the pooled interest-bearing account if the lawyer made a good faith determination that the funds fit the provisions of this rule.

### **Rule 1.15C. Trust Account Overdraft Notification**

- (a) *Clearly Identified Trust Accounts Required.* Attorneys who practice law in Vermont shall deposit all funds held in trust in Vermont in accordance with Rule 1.15 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 Professional Conduct Board.

The request letter raises the question whether there is a distinction between the treatment of funds held by an attorney in a firm and funds held by "closing companies." In response the Committee reiterates the Conclusion in Opinion 2001-2 that an attorney may form a closing company, title company or escrow company separate from the attorney's firm, and that handling real estate closings is a law related business. The VRPC apply to an attorney handling real estate closings whether operating in a traditional firm setting or under the aegis of a title company, closing company or escrow company.

The attorney's obligation with regard to funds delivered into the hands of the attorney is clearly stated in VRPC 1.15 and VRCP 1.15A. Any funds, whether delivered to the attorney by the client<sup>1</sup> or a third party (seller, Realtor®, lender, for example) are subject to the applicable rules. It is interesting to note that Rule 1.15 speaks of funds delivered to the attorney by clients and third parties, but Rules 1.15A, 1.15B and 1.15C speak only of "client funds". Although not all of the funds delivered to the attorney will ultimately belong to the client, or be disbursed to the client (whether the client is the lender, buyer or both), the funds were delivered to the attorney for the benefit of the client and to further the representation of the client. Treating all of the funds delivered to the attorney for a particular closing without regard to the source of the funds or the ultimate recipient of the funds as "client funds" within the meaning of the rules is reasonable given the practical realities of nature of real estate closings.

Client funds must be deposited into a pooled interest account ("IOLTA account" for the purposes of this Opinion) pursuant to VRPC 1.15B (a). In general, the funds held by the attorney will only be in the attorney's possession for the same day, or perhaps, at most 2-3 days, if there is a problem with the closing that delays disbursement of the funds. Although the sums involved in many closings are relatively large, running from hundreds of thousands of dollars to millions of dollars, and busy attorneys may have

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<sup>1</sup> Opinion 2001-2 also addresses the issue of representing multiple parties in a single real estate transaction. Opinion 2001-02 discusses a framework within the rules that allows an attorney to represent a lender and purchaser in the same transaction. The Opinion includes a discussion about preliminary conclusions that the attorney must make and the obligations of the attorney with respect to each of the multiple clients.

several closings proceeding from the receipt of funds, to closing, to disbursement in the same day, the likelihood that there will be substantial interest benefiting a particular client is remote. The only exception to the general rule of requiring deposit of client funds into an IOLTA account exists when the attorney has a reasonable expectation that the funds will generate significant interest for the client. There may be circumstances where funds are withheld from disbursement at the closing as “post-closing escrows” to insure that something happens after the closing occurs. If those funds are minor in amount or are to be held for a limited time, those post closing escrows must also be held in an IOLTA account if the funds. The test to determine whether the funds should be held in the IOLTA account is the attorney’s determination that the funds will not generate a substantial amount of interest for the beneficiary of the funds. On the other hand, if the sums are large, or the period during which the sums are to be held is long, or both, the attorney must consider whether the interest to be earned is substantial and must discuss that possibility with the client. If there is a reasonable expectation that the post-closing escrow funds will generate substantial interest, the attorney may properly deposit those funds in a separate account that is not an IOLTA account, so that the interest may be collected and paid to the appropriate party.

The exception to the general rule is that an attorney’s client or the parties to a transaction may direct that funds be held in an interest bearing account with the interest being retained in the account and disbursed according to an agreement. In that circumstance the attorney should follow the client’s or parties’ direction with respect to maintaining the funds and the disbursement of the funds.

Upon reaching the conclusion that most funds collected in connection with real estate closings must be deposited into IOLTA accounts, it is easy to reach the conclusion that the IOLTA accounts must comply with the requirements of VRPC 1.15C requiring overdraft notifications. There are no exceptions to that rule. All funds held by an attorney for a client must be maintained in an account with overdraft notification. It is also clear that the post-closing escrow funds (see previous paragraph) must also be deposited in trust/escrow accounts that provide for overdraft notification as provided in VRPC 1.15C, as those funds are trust funds within the meaning of the rule, even though not deposited in an IOLTA Account.