

**T**his past September, the State Bar Committee on the Rules of Professional Conduct (“the Committee”) spoke to an issue that has been percolating (some might say festering) for quite some time and has, in some quarters, become controversial—whether it was ethically permissible for lawyers to accept from clients payment by credit card for retainers or other forms of advance payments for fees not yet earned and/or costs not yet advanced. In holding that it was not, the Committee brought to an end (at least for the present) one of the ways credit cards have been employed by those seeking legal services.

That opinion raised important issues for lawyers and clients.<sup>1</sup> It also led to activity at the State Bar, including a petition to the Arizona Supreme Court, and the Court’s adoption of an order that at least temporarily suspends the opinion’s effects.

This article examines the opinion and the Committee’s well-founded concerns. It addresses what the recently adopted Court order solves—and what has still been left unaddressed.

### **What the Committee Said**

The Committee’s Opinion starts with certain propositions that have been long established. Payments from clients for fees that have been earned, which would include advance fees properly designated as “earned upon receipt,” and reimbursements for costs already advanced on the client’s behalf, must be deposited in the lawyer’s or law firm’s operating account, rather than in a trust account.<sup>2</sup> The deposit of funds of this character into the trust account results in the improper commingling in that account of funds that belong to the client with funds that are the

## The Ethics Credit Crunch

BY DANIEL J. MCAULIFFE

lawyer’s.<sup>3</sup> The Committee had previously concluded, and reaffirmed in this opinion, that it is ethically proper for lawyers to allow clients to make payments of this nature by credit card, provided the lawyer takes reasonable steps and precautions to preserve the confidentiality of client information that may become involved in the handling of the transaction.<sup>4</sup>

Payments of retainers or other advance fee payments, however, must be deposited into the lawyer’s trust account and remain there until they are earned, at which point they must be withdrawn and placed in the operating account.

It is at this point where a problem arises when the client desires to make this payment by credit card.

Many, but apparently not all, credit card providers or issuing institutions require that a merchant receiving funds from that provider—which in this case would be the lawyer or law firm—designate a single account into which the provider will deposit funds following a credit card charge being processed.<sup>5</sup> Moreover, again in almost all cases, the provider grants the cardholder a peri-

od of up to 120 days from the date of the transaction to dispute any charge, and retains the right to access the merchant's account to debit it for any funds previously deposited that are the subject of such a dispute. There also appear to be some providers that prohibit charging a customer's card for future services.<sup>6</sup>

If the lawyer accepts the retainer and/or other advance payment from a client via credit card, the funds must be deposited into the trust account, and it will be that account that most credit

card providers will treat as the merchant account. When fees are earned chargeable against that retainer, the lawyer is required to remove them from the trust account and place them in the operating account. However, the client still has up to 120 days (presumably running from the date of the "retainer charge") to dispute those charges and, when and if the client does that, the credit card provider will debit the trust account, not the operating account, for the amount in dispute.

The funds the credit card provider is in effect removing from the trust account will almost always, if not inevitably, be funds that belong to other clients.<sup>7</sup> The debit could even cause the trust account to become overdrawn.

Because of that circumstance, the Committee concluded that it is not ethically permissible for Arizona lawyers to accept payments by credit card for unearned fees or costs anticipated but not yet advanced. A logical corollary of this conclusion, also expressed in the opinion, is the companion one that a lawyer may accept a single non-cash payment from a client that consists of

funds that are partly the client's and partly the lawyer's *only* by check, money order or electronic-fund transfer. Credit card payments of that nature are not permitted, because such payments must be initially deposited into the trust account.<sup>8</sup>

### What the Committee Feared

While it is couched in the language of the ethical and trust account rules, a fair reading of the opinion reveals what troubled the Committee.

Essentially, the net effect of the arrangement before it was that the lawyer was granting a third-party lender to a client the right to access a trust account, which might contain funds belonging to many clients. That lender could make a sizable withdrawal, through the processing of a debit.<sup>9</sup> Such an arrangement is troubling at best, and the Committee properly concludes, "The potential danger to the property of other clients created by the credit-card provider's right of access precludes use of the trust account as the designated merchant account for credit-card transactions involving payment of expected fees or costs."<sup>10</sup>

In tacit recognition that its opinion was effectively invalidating an arrangement frequently used both by clients in need of legal services and lawyers seeking security for providing them, the Committee went on to discuss three options Arizona lawyers and clients can consider as replacements. Unfortunately, none of these options effectively serves the needs that have made the use of credit cards for these transactions advantageous. They also present risks or disadvantages the credit card transaction avoids.

### What the Committee Proposed

1. The first option is "to designate advance fees paid by credit card as 'earned-upon-receipt' or 'non-refundable.'"<sup>11</sup> If that is done, then the "retainer funds" are deemed earned, and they can be deposited in the lawyer's operating account. Far more important, it will then be the operating account, rather than the trust account, that serves as the "merchant account" and will be subject to the lending institution's right of access and debit in the event of a dispute.

**Potential Problem.** Although that would work, it also has the flavor of encouraging labeling the underlying transaction something different than what was intended in order to avoid trust account administration problems. In addition, as the Committee notes, an advance fee can only be properly designated "earned upon receipt" and/or "non-refundable" if the lawyer's written fee agreement contains the advice to the client specified in ER 1.5(d)(3).<sup>12</sup> The Arizona Rules of Professional Conduct have



## The Ethics Credit Crunch

required written fee agreements since 2003, and experience has shown that securing compliance with that requirement by practicing lawyers has not been universally successful. There is no reason to assume that experience with subjecting lawyers faced with this problem with a requirement for even more detailed written disclosures to clients will be any more successful. This alternative may simply result in lawyers walking into violations of ER 1.5 in order to avoid a violation of ER 1.15.

2. The second option discussed by the Committee entails having the lawyer secure and retain the client's credit card number and, as bills become due, processing charges against the account for payment of them.<sup>13</sup>

**Potential Problems.** One obvious problem with this alternative is that the lawyer would be undertaking an obligation to protect the confidentiality and security of the client's credit card information, and would probably have liability exposure for failure to do so.<sup>14</sup> The more serious flaw is that it does not necessarily give the lawyer what is sought when an advance retainer is requested—security for payment. It is safe to assume that the amount of the advance retainer generally requested will approximate the lawyer's estimate of the total fees and expenses that will be necessary to complete the engagement. Having those funds on deposit in the lawyer's trust account, and available to be drawn against as fees are earned and costs are actually incurred, provides the lawyer with excellent security for payment. Having a credit card number on file does not necessarily do so.<sup>15</sup>

3. The final option discussed by the Committee is “for the client to take a cash advance on the client's credit card and pay the lawyer in cash.”<sup>16</sup>

**Potential Problems.** As the Committee itself notes, however, this may only operate to increase the costs of securing legal services for clients, because many (but not all, surprisingly) credit card providers charge a higher interest rate for cash advances than for ordinary purchases.<sup>17</sup> Most people probably did not anticipate or budget for the need to hire a lawyer. One of the benefits of a credit card to such clients is that it permits this unanticipated expense to be spread out, and planned for, up to 24 months. Increasing the carrying charges associated with the transaction may operate to put legal services out of reach for many prospective clients of modest means.<sup>18</sup>

Another unarticulated premise that appears to underlie the Committee's opinion (and the thinking of many charged with enforcing compliance with the trust account rules) is adherence to what can be termed the “single nanosecond” rule of trust account administration. Under this regime, if funds that belong to the client, rather than the lawyer, reside in the lawyer's operating account for even a single nanosecond, then improper commingling has occurred, and ER 1.15 and the trust account rules have been violated.

Such a bright-line rule has much to commend it. It is far easier to enforce, and it is far easier to comply with. It also avoids the slippery slope that would be involved in debating how long such commingling should be tolerated before a violation is deemed to occur. However, when that rule comes up against commercial realities and has a negative impact on the availability of legal services for people of modest means, then it may be appropriate to revisit and change it, particularly if that can be done without sacrificing the benefits of the current clear line in the sand.

### The Bar's Proposal

To its credit, the State Bar recognized, almost immediately upon issuance of Opinion 08-01, that the opinion might have a negative impact on the availability of legal services of modest means, and on the practices of lawyers who serve them, and that an effective solution would require an amendment to the current rules concerning the maintenance and administration of trust accounts.

One proposal initially considered was to amend Rule 43 of the Rules of the Supreme Court<sup>19</sup> (and ER 1.15(c)) to add a provision that would permit a lawyer who receives advance fee and cost retainers via credit card to deposit those funds, temporarily, in the lawyer's operating account. Under that initial proposal, the amended rules also would provide that, if the lawyer failed to transfer such funds to a trust account within five business days, there would be a conclusive and irrebuttable presumption that a violation of ER 1.15 had occurred.<sup>20</sup> That proposal was not pursued, however, because of a concern that it would be difficult to monitor compliance, and it did violate the “single nanosecond” rule discussed above.

The proposal eventually approved by the Bar's Board of Governors, and submitted to the Supreme Court for its consideration (and eventual adoption on an emergency basis), also called for the amendment of both Rule 43 of the Supreme Court Rules and Rule ER 1.15(c) of the Arizona Rules of the Supreme Court, but in a very different fashion. The Bar's proposals use as a model the provisions of existing rules that allow the distribution from trust accounts of certain limited-risk funds without the lawyer being required to wait for the deposit that is the source of those funds to be finally settled and credited to the trust account.<sup>21</sup> In the Bar's

Most people probably did not anticipate or budget for the need to hire a lawyer. One of the benefits of a credit card to such clients is that it permits this unanticipated expense to be spread out up to 24 months.

experience, the risk of failure of such deposits was of an order of magnitude comparable to the risk of a dispute producing a credit card company's chargeback to a trust account.

Under the Bar's proposals, lawyers may permit funds from a credit card charge for the payment of advance fees, costs or expenses to be deposited into a trust account, but only if the lawyer has at the time sources of funds available to replace any funds that may be debited from the account due to a dispute-inspired chargeback. If the lawyer subsequently learns of or is notified that such a chargeback debit has been made, the lawyer must deposit into the trust account, within three business days, the lawyer's own funds in an amount sufficient to cover the amount debited and any associated fees or charges that may have been imposed.

### What the Proposal Does—and Does Not—Solve

Both the rule and the accompanying comment make it clear that accepting credit card payments for advance fees and costs is at the lawyer's own risk, and lawyers are encouraged to explore the possibility of using credit card processing services that permit deposits into trust accounts, but process chargeback debits against the operating account, which avoids the problem. However, these proposals will validate at least some instances where the lawyer grants a third-party lender to a client the right to access the lawyer's trust account and withdraw funds—the very circumstance that appeared to trouble the Committee. The Board of Governors apparently felt that granting such access under the conditions imposed was an acceptable risk—whether the Court (or the Committee, should the issue come back before it) will ultimately agree with that assessment is another question.

Under typical circumstances, proposed amendments of this nature would not have taken effect, even if approved by the Court, until Jan. 1, 2010. Together with its petition, the Bar also filed a motion asking the Court to give it expedited consideration. Although it has not been receptive to such requests in the past, in a tacit recognition of the exigent nature of the situation, the Court recently adopted the proposed amendments on an emergency (and perhaps interim) basis, effective Jan. 1, 2009, with a public comment period to follow through May 20, 2009.<sup>22</sup> This strongly suggests that the Court will revisit the wisdom and efficacy of these amendments at its next scheduled Rules Agenda

## SUPREME COURT GRANTS EMERGENCY RULE AMENDMENT


In December, the Supreme Court adopted, “on an emergency and experimental basis,” an amendment to Rule 42, ER 1.15, and Rule 43, ARIZ.R.S.Ct., to authorize lawyers to accept credit card payments for advance fees, costs and expenses. This was in response to a State Bar petition aimed to address the impact of Ethics Opinion 08-01, which concluded that lawyers and law firms may not ethically accept such payments.

The Supreme Court emergency order is effective Jan. 1, 2009. The public comment period runs until May 20, 2009.

- To read the order, go to [www.supreme.state.az.us/rules/Recent\\_rules.htm](http://www.supreme.state.az.us/rules/Recent_rules.htm), click on R-08-0030.
- To read the Bar's petition and to comment, go to [www.dnnsupremecourt.state.az.us](http://www.dnnsupremecourt.state.az.us), click “Court Rules Forum,” click “View of File Rule Change Petitions,” then on “R-08-0030” (next to *Rules of the Supreme Court*).
- To read Ethics Opinion 08-01, adopted Sept. 26, 2008, go to [www.myazbar.org/Ethics](http://www.myazbar.org/Ethics).



in September 2009.

If adopted on a permanent basis, these amendments would facilitate, albeit not really encourage, accepting credit card payments of advance retainers from prospective clients. They would not, however, cure the “third party access” problem associated with accepting credit card disbursements into trust accounts. In fact, they would institutionalize it. Lawyers whose practices have been affected by Opinion 08-01 should strongly consider weighing in with the Court, in the public comment period that is now under way, on the substantive merits of what has been proposed and/or alternatives that might be considered. 

### endnotes

1. The issue has been alluded to at some State Bar CLE ethics seminars, and other seminars conducted primarily for small and medium-sized law firm managers, and informal advice provided that this “may be a problem.” It is clearly preferable to now have a formal pronouncement on the subject, whether one agrees with it or not. On that subject, while this article criticizes some subsidiary conclu-

sions expressed by the Committee, and its failure to explain others, under the current state of the ethical rules, it is hard to take issue with its ultimate conclusion.

2. See Formal Ariz. Ethics Op. No. 99-02.

3. *Id.* It seems to be accepted that any such commingling, unless specifically authorized by rule (which it may be in the case

where funds are needed to cover bank service charges), is an automatic ethics violation, and the authority generally cited for that proposition is the comment to Rule ER 1.15.

Paragraph 2 of that comment is not quite so forceful on that subject, however, and says only that “... normally it is impermissible to commingle the lawyer's own funds with client funds ...” (emphasis supplied).

4. See Formal Ariz. Ethics Op. No. 89-10.

5. Reportedly, there is at least one large financial institution doing business in Arizona that offers to lawyers and law firms the option of having the operating account serve as the “merchant account,” even though the charged retainer is deposited into the trust account.

6. The Committee mentions this phenomenon at least twice but does not really elaborate on the possible ethical implications of it,



other than to observe, at page 5 of the opinion, that, “If a lawyer enters into an agreement with a credit-card provider with such a restriction, the lawyer is ethically required to respect the contract” (citing Rule ER 8.4(c)’s prohibition on conduct involving dishonesty, fraud, deceit or misrepresentation). The notion that every breach of contract by a lawyer also may be an ethical violation, as well as that the failure to honor such a restriction in a merchant account agreement with a credit card issuer somehow rises to the level of fraud or deceit, are hardly self-evident propositions, and warranted a further explanation, which the opinion does not furnish.

7. The Committee mentions this, but it seems wholly extraneous to the analysis of the ethical issue being addressed. Because dollars are fungible commodities, this will occur regardless of whether a credit card charge is involved or not. Assume that the client makes a cash deposit of a retainer of \$25,000, which is the lawyer’s estimate of the total cost of the engagement, and which is promptly deposited in the lawyer’s trust account. If the fees for the engagement turn out to be only \$20,000, the lawyer is obligated to remit to the client the \$5,000 balance being held in the trust account for the benefit of that client, and the dollars used to make that remittance will almost never be the same dollars the client deposited.
8. Lawyers can still accept credit card payments for earned fees, earned-upon receipt retainers, and for the reimbursement of costs that have been advanced.
9. As the Committee had previously observed in its Formal Op. No. 89-10, the issuance of a credit card is nothing more than the extension of a short-term line of credit to the cardholder by the issuing financial institution.
10. Formal Op. No. 08-01, p. 6, available at

- www.myazbar.org/Ethics. Earlier in the opinion, the Committee states the same proposition somewhat more succinctly: “The right of access renders designation of the lawyer’s trust account ethically impermissible.” *Id.* at 5.
11. Formal Op. No. 08-01, at 8.
  12. That rule requires that the client be “simultaneously advised in writing that the client may nevertheless discharge the lawyer at any time and in that event may be entitled to a refund of all or part of the fee based upon the value of the representation . . . .” In other words, you may call such a fee *earned upon receipt*, and you may treat it that way for purposes of where it’s deposited, but you may very well have to pay some portion of that “earned upon receipt” fee back to the client.
  13. As described in the opinion, this entails having the lawyer and the client “enter into an agreement whereby the client allows the lawyer to keep credit-card information on file and charge earned fees and advanced costs against the card on a periodic basis.” The Committee adds that, under an arrangement of this nature, the client would have to be invoiced and given a reasonable time to dispute any items appearing on the invoice before a charge could be processed.
  14. This is an option that many online retailers offer to customers, but Internet retailers presumably have more experience with, and have probably developed more sophisticated systems for, keeping such information secure than does the typical law office.
  15. Many things can happen between the time the credit card number is furnished to the lawyer and the time when a charge for fees and expenses must be processed. The card could be cancelled or the client could have charged up to, or over, the card’s credit limit, leading to the declination of the charge.
  16. Formal Op. No. 08-01, at 9.
  17. This should not be particularly surprising. In the typical credit

card transaction, the credit card company has two sources of income: (1) the amount of the discount applied to its remittance to the merchant involved, and (2) the interest charges paid by the card holder. Where a cash advance is involved, there is no payment to a merchant to discount. Notwithstanding, a wholly unscientific survey of some credit card issuers doing business in Arizona indicates that not all impose a higher percentage finance charge on cash advances.

18. There is yet a fourth possible option that the Committee did not discuss: waiting out the dispute period before submitting a bill for services and costs. While the scope of the “dispute” clauses involved is not explained in the opinion, presumably they only reach disputes concerning charges against the credit card involved. The posting of the advance retainer does not seem a fertile ground for such disputes. Rather, it can be assumed that it will be the issuance of a following invoice for work performed, and costs incurred, that will prompt such a controversy. That will not, however, be a transaction processed on the credit card, and the card holder will have to rely on the initial advance retainer transaction as the basis for the dispute. The lawyer could presumably simply wait until the dispute period expires before issuing such an invoice.

Under this option, however, the funds for the retainer would still have to be deposited in the trust account, and that account would still be the “merchant account” that the lender could access in the event of a dispute. The lack of any mention of this possible alternative underscores the conclusion that the true vice in this arrangement is the granting of access to a third party to the trust account.

19. Some will undoubtedly note that the amendment proposed is to Rule 43, while Formal Op. No. 08-01 discusses Rule 44. Both are correct. As part of a restructuring of the trust account rules ordered by the Supreme Court in September,

Rule 44 will be renumbered as Rule 43, and amended, effective Jan. 1, 2009.

20. This proposal would have avoided the problem of granting credit card companies a right of access to the lawyer’s trust account; the operating account would receive the funds and serve as the merchant account. It was also a form of bright-line rule, albeit with a five-day grace period built in, because the presumption of a violation if a timely transfer was not made would be conclusive. Determining compliance with it, however, might have necessitated authority to monitor activity in lawyer’s operating accounts.
21. Under what will become Rule 43(b)(4), lawyers may permissibly disburse from trust accounts funds that have not as yet been collected and credited to that account where the deposit that is the source of those funds is: (1) a certified or cashier’s check; (2) a bank check, official check, treasurer’s check, money order or similar instrument where the payor is a bank, savings and loan association or credit union; (3) a check issued by the United States, the State of Arizona or any agency or political subdivision of the State of Arizona; or (4) a check or draft issued by an insurance company, title insurance company or a licensed title insurance agency authorized to do business in Arizona. Such disbursements are expressly made at the lawyer’s risk and, if the deposit fails for some reason, the lawyer must make up the resulting shortfall within three business days from the lawyer’s own funds. Under current economic conditions, that risk almost necessarily has to be viewed as enhanced.
22. Under the Court’s normally prescribed schedule for consideration of proposed Rule amendments of this nature, petitions filed before January 10 in any given year are generally circulated for comment, and then considered by the Court at its annual rules conference the following September. *See generally* Rule 28, ARIZ.R.S.Ct. What the Court has done is to provide an emergency solution to the problem, while still preserving the right of the interested public to comment, which Rule 28 effectuates.