



# ALLIED WORLD

## How to Handle Disputes Over Funds Held in a Trust Account

Attorneys routinely hold monies in their trust accounts funds that are disputed by two or more persons, one of which is sometimes the attorney himself. It is important to be aware of the law pertaining to the fiduciary duties of an escrowee (or holder of funds in a trust account for the benefit of more than one person) as this can help avoid claims.

ABA Model Rule 1.15(e) explains the two-step process for dealing with disputes over funds held in an escrow account or trust account. First, the attorney is to "promptly distribute all portions of the property as to which the interests are not in dispute." After the non-disputed funds are disbursed, the attorney is then directed to keep the disputed portion of the funds separate from his funds until the dispute is resolved.

From the point of view of civil liability, the attorney should recognize that he owes duties not only to his client, but to the others who claim the disputed funds. An escrow agent is a "trustee" of both the party making the deposit and the party for whose benefit it is made and has a fiduciary duty to act in accordance with the terms of the escrow agreement. *Meyers v. Rockford Systems, Inc.*, 254 Ill.App.3d 56, 64, 625 N.E.2d 916, 922 (1993); *Ortman v. Kane*, 389 Ill. 613, 621, 60 N.E.2d 93 (1945).

Fiduciary duties involve a heightened standard of care. Benjamin Cardozo described the fiduciary duty as "Not honesty alone, but the punctilio of an honor the most sensitive is the standard of behavior." *Meinhard v. Salmon*, 249 N.Y. 458, 464 (1920).

The attorney acting as escrowee or who is holding disputed funds in a trust account may not simply disburse the funds as directed by the attorney's client, or as he believes they should be disbursed. An escrowee is not the judge of whether the conditions of the escrow agreement have been performed. *Filosa v. Pecora*, 44 Ill.App.3d 912, 358 N.E.2d 1213 (1976), *Heritage Insurance Co. v. First National Bank of Cicero*, 629 F.Supp. 1412, 1418-19 (N.D. Ill. 1986).

If the attorney and his client are the parties disputing the ownership of funds in the attorney's trust account, he may not ethically disburse the funds to himself, even if the attorney is certain that he is entitled to the funds. In the matter of *In re Allen*, 08 CH 78, discipline on consent allowed, Supreme Court of Illinois Order No. M.R. 22986 (March 16, 2009), the attorney was suspended on consent for six months for releasing \$30,000 in escrow funds to his client after being informed that the other party would not authorize the release of the funds. The attorney represented the seller in a real estate transaction. The parties entered into several escrow

agreements that provided for the attorney's holding of monies during the completion of a punch list. The attorney released part of the funds to his client notwithstanding the fact that the other party disputed the seller's right to receive the funds.

In another disciplinary action, *In re Lofchie*, 90 CH 370, Supreme Court of Illinois Order No. M.R. 9563 (January 25, 1994), the Court disciplined an attorney for disbursing escrow funds to one party to the escrow agreement, holding that, having assumed the role of escrowee, the attorney was bound to adhere to the terms of the escrow agreement and refrain from favoring one party over the other.

New York City Bar Formal Opinion 1986-5 (July 14, 1986) addressed the issue of an attorney's handling of funds in a trust account when the client and the attorney both had claims on at least a portion of the funds. The Opinion stated that any undisputed portion of the funds should promptly be paid to the client or third party. The attorney should then notify the client of his claim to the funds as fees. If the client disputes the attorney's entitlement to those funds, he may not pay out the disputed portion to himself, but should hold the funds in the trust account until the dispute is resolved.

Where the dispute cannot be resolved in a timely manner, state law may permit the attorney to interplead the funds. Fee disputes may also be resolved through alternative methods such as fee dispute arbitration.

## Risk Management Tips

- Be aware of any specific state rules, regulations or ethics opinions on the fiduciary duty of an escrowee or holder of funds or holder of funds in a trust account for the benefit of more than one person).
- Should you have questions, consider consulting with an attorney or risk management professional.

**We invite Allied World policyholders to access additional information on this and other Risk Management topics.** The lawyers' risk management website, <http://awac.lawyerlaw.com>, contains resources as well as related topics.

Also, the **Risk Management Hotline** is included for up to 2 free hours per year, per firm of confidential advice regarding risk management questions that your law firm may have. If you are an Allied World policyholder, the hotline can be accessed through the risk management website, <http://awac.lawyerlaw.com>. Once you log on to the website, the link to contact the hotline is on the upper left side, under the Allied World logo.

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