ETHICS CURBSTONE

By Donald R. Lundberg

What's in your trust account? When clients pay by credit card

With online bill paying and near-universal acceptance of credit cards, it seems like I rarely write a paper check anymore. At this rate my current supply of "old school" checks should last until mid-century. It will be great if I'm still around to use them.

Because clients follow a similar pattern, lawyers have adapted by accepting credit card payments. Not only does this increase client convenience, it also gives another payment option to clients who may not have cash on hand to pay their lawyers.

Before wading further into this topic – a disclaimer: My relationship with credit cards is limited to trying to wear one out before its expiration date. I am not a banking lawyer, nor do I play one on TV. You should turn elsewhere for technical guidance on being a credit card merchant.

Some vocabulary

As in most specialized fields, credit card processing has its own terminology. A vendor, like a lawyer, who accepts credit cards is known as a "merchant," and the account into which the credit card payments are deposited is called a "merchant account." The bank where the merchant has the merchant account is called the "acquiring bank." The bank that issues a credit card to a customer is known, logically, as the "issuing bank."

Donald R. Lundberg
Executive Secretary
Indiana Supreme Court
Disciplinary Commission
Indianapolis, Ind.

Credit card payments for receivables – no problem

No ethical concern is presented when a lawyer accepts a credit card payment in an operating account for fees already earned because the trust account is not implicated. Also, our Supreme Court has held that a fixed fee is deemed earned upon receipt and need not be deposited into trust. So a client's payment of a fixed fee can readily be handled as a credit card transaction, with the fee going directly into an operating account. See *Matter of Kendall,* 804 N.E.2d 1152, 1157 (Ind. 2004). As we will see, ethical questions do arise when credit card transactions are linked directly to lawyer trust accounts.

Credit card payments for funds belonging in trust – a problem

May lawyers accept credit card payments if those payments must go into trust? Generally, no. There may be an exception, which I will describe at the end. But first, I'll explain why this is a problem.

Lawyers often receive payments from clients that must go into trust, not the operating account. For instance, clients often advance funds to be used in the future to pay for expenses associated with the representation, like filing fees, expert witness fees or deposition costs. Another example is when the client gives the lawyer a deposit against attorney fees to be earned in the future, usually on an hourly basis. Until earned, these funds belong in the trust account. *Kendall* at 1160.

Go directly to trust, do not pass go

Let's dispose of one tempting solution right off the bat. If a client payment is destined to be placed in trust, the credit card payment may not be initially deposited in an operating account – even if the lawyer plans to promptly transfer the funds into trust. Rule of Professional Conduct 1.15(a) requires client or third-party funds to be held separate from the lawyer's own funds. For the brief period of time that the would-be trust funds occupy the same account as the lawyer's own funds, they are at risk.

For example, the client funds can be removed from the account if there is a tax levy on it; the account will be frozen if a judgment creditor serves interrogatories on the bank incident to proceedings supplemental; they could be subjected to a bank set-off if the lawyer is in default of a credit obligation to the bank. This is not an acceptable solution.

So what about Plan B: May the lawyer arrange with the credit card company for deposits to go directly into the trust account? In other words, may a lawyer designate a trust account as the merchant account associated with credit card transactions? If doing so means non-trust funds will be deposited into trust before being transferred elsewhere, this would constitute improper commingling in violation of Rule 1.15(a).

The merchant fees problem

Even if the lawyer sets it up so that only trust funds go into the trust account, this approach is seriously flawed. First, there is the problem of the credit card company's fees. The merchant agreement will authorize the acquiring bank to deduct various fees related to credit card transactions from the merchant account. Authorizing any third party to invade your trust account should give you pause.

Merchant fees include annual and monthly fees and a variety of service fees, some of which are based on a percent of each transaction and others as a flat fee per transaction. Some fees vary with the merchant's credit card volume and whether a transaction is in-person or remote. Figuring out

the fees associated with a particular transaction can be complicated and time consuming.

The credit card company will deduct its fees from the merchant account into which the credit card payments are deposited. In our example, this would be the trust account. If the lawyer doesn't have enough of his or her own funds in the account to offset those fees, they will be deducted from other funds on hand – meaning funds held in trust for clients. That is a very bad thing. Permitting it breaches the fiduciary duty to safeguard trust funds. It could even be criminal conversion if the lawyer knows of the unauthorized use.

A 'nominal' balance

Maybe the solution lies in the lawyer keeping enough of his or her own money in the trust account to defray credit card merchant fees as they are assessed. Depending on the level of trust account activity, this could mean keeping hundreds of dollars of the lawyer's own money in the trust account, especially given how hard it is to accurately predict what the fees will be. Rule 1.15(b) states that, "A lawyer may deposit his or her own funds reasonably sufficient to maintain a nominal balance in a client trust account." In 2005, the Indiana Supreme Court rejected the ABA's Model Rule 1.15(b) language, which states: "A lawyer may deposit the lawyer's own funds in a client trust account for the sole purpose of paying bank service charges on that account, but only in an amount necessary for that purpose." I suggest that under Indiana's rule keeping hundreds of dollars in trust to offset credit card service charges exceeds a "nominal" balance.

The chargeback problem

Here's another problem – the chargeback. All credit card companies have a mechanism for cardholders to challenge charges they believe were not authorized or are disputed for some other reason. There are time limits for challenging a charge – normally a fixed number of days after the date of the monthly statement on which the charge appears. If the cardholder complies with the dispute procedures, the issuing bank will forward the dispute to the acquiring bank. Without giving advance notice to the merchant, the acquiring bank will reverse the credit to the merchant's account and hold the funds

(continued on page 28)

pending resolution of the dispute. The merchant (in our case, the lawyer) may dispute the chargeback, but in the meantime, the funds have been deducted from the account and are being held in limbo.

Unavailable funds

There's the rub. If the merchant account is a trust account, the lawyer can't be certain the funds are available to be disbursed for a long time. This leaves the lawyer in the untenable position of holding the credited funds in trust for at least as long as the client has to dispute a charge before disbursing them for a filing fee, earned attorney fees or the like. This could easily be 90 days after the original charge – well in excess of the typical waiting period for deposited checks to be collected through banking channels.

If the lawyer removes the funds from trust before the dispute period elapses, there is a risk that the credit will be reversed pending resolution of a client-initiated dispute. That chargeback will be debited against the balance in the account. If the credit card customer's funds are no longer in the account, the chargeback will be debited from other funds in trust – meaning other clients' funds. This would be serious misconduct because other clients did not authorize use of their funds for this purpose.

A nifty solution

What's the solution? Not taking credit cards for payments that must go into trust is one solution, but that can place the lawyer at a business disadvantage and may work a hardship on some clients.

At the risk of sounding like a shill for the nice people who agree to publish these periodic musings about legal ethics, you should know that the Indiana State Bar Association makes available to its members a law firm merchant account program that solves the two problems outlined above. The key to the solution is that client credit card payments that belong in trust are credited entirely to the trust account and any fees associated with the transaction are deducted from a designated non-trust account – an operating or business account. The chargeback problem is addressed in the same way. In the rare event a client timely disputes a charge, the disputed funds will not be deducted from the trust account. Instead, the disputed charge will be deducted from the same non-trust account as is used to pay merchant fees. The broader concern about having authorized a third party to invade your trust account disappears.

Consequently, credit card payments become fully available for disbursement from trust when earned upon being credited to the account by the acquiring bank; and more importantly, there is no risk that fees and chargebacks will be debited against other client funds held in trust. Another benefit is that the merchant may direct credit card payments to either the trust account or the operating account, depending on where they belong.

For further information

This credit card program is operated by a company called Affiniscape Merchant Solutions. More details are available under the "Members Benefits" section of the ISBA's Web site: ***www.inbar.org***. Scroll down to "Law Firm Merchant Account" and follow the link. There may be other similar programs out there, but I'm not aware of them. ⚖

The views expressed in this column do not necessarily represent the positions of the Indiana Supreme Court or the Disciplinary Commission.