BY: Nicholas C. Cooper

RESIST the TEMPTATION TO TAP THE ESCROW

How low must the cash flow go before lawyers become tempted to tap into the escrow?

As of late, interest rates continue to set record lows while the stock markets continue to set record highs. Nevertheless, the recurring plight of the single practitioner is that cash flow more often than not barely meets minimal financial needs. In this environment, the temptation to "borrow" from those idle escrow funds can be strong. Particularly when it is realized that those funds are exclusively within the lawyer's control and subject to only minimal scrutiny.[1]

So, when as a result of these dire financial straights the attorney who, with every good intention of making prompt repayment, succumbs to temptation and takes a "loan" from the escrow account, he or she should be aware that disbarment is a probable result for such misconduct, unless it is determined that the attorney's action lacked venal intent or otherwise, substantial mitigating factors exist.

The following is a review of selected relevant cases dealing with the issue of attorney "conversion" of client funds:

For many years the precise definition of "conversion" by an attorney of funds entrusted to him was in doubt. Therefore, disbarment[2] often resulted absent compelling circumstances[3] simply from proof of an escrow obligation in which, during its pendency, the balance in the account fell below the required amount. This writer was always troubled by the fact that in such cases disbarment apparently could result without any proof of willfulness, venality or evil intent to defraud.

This seemed an anomalous result given the definition of fraud as set forth in the definitions section of the Code of Professional Responsibility which specifically provided that:

> "Fraud" does not include conduct, although characterized as fraudulent by statute or administrative rule, which lacks an element of scienter, deceit, intent to mislead, or knowing failure to correct misrepresentations which can be reasonably expected to induce detrimental reliance by another.[4]

It was, therefore, enlightening when the Appellate

Division, First Department, rendered its 1990 decision in *Matter of Altomerianos*, in which the Court not only recognized the Code fraud definition as compelling, but stated clearly as follows:

> that venal intent is a necessary element to DR 1-102 (A) (4) we think is compelled by the definition of fraud given in the Definitions section of the Code as "not includ[ing] conduct . . . which lacks an element of scienter, deceit, intent to mislead, or knowing failure to correct misrepresentations which can be reasonably expected to induce detrimental reliance by another".

Mr. Altomerianos had placed escrow funds in a general business account and disbursed funds for his and his clients' benefit contrary to the terms of the escrow agreement. He was of the belief that his obligation was merely to replenish the commingled account. The hearing panel found that his use of the funds was without motivation or intention to misappropriate to his own use.

Indeed, the court rejected the previously long-held notion that proof of conversion was established merely by proof that the balance in the escrow account fell below the amount required:

> But, whatever the exacerbating and mitigating circumstances relevant to respondent's admitted violation of 22 NYCRR 603.15(a) and DR 9-102(A) . . . [rules requiring preservation of clients' funds in special account] . . . respondent's commingling should not ipso facto implicate him in the violation of the DR 1-102(A)(4) merely because the balance in the commingled account fell below the escrow amount and was not restored prior to the institution of disciplinary proceedings.

The lesson of Altomerianos is that any proceeding based upon a charge of conversion, which by definition must include an allegation of a violation of DR 1-102(A)(4) (fraud, deceit or misrepresentation), linked with an allegation of violation of DR 9-102 (preservation of clients' funds in special accounts), may be proven only if it is established that the attorney acted with "venal intent".

Indeed, this principle has been recognized by the Court of Appeals in *Matter of Russakoff* in which the Court of Appeals noted that the attorney:

> affirmatively denied any "intentional or willful" misconduct. While that denial may not have been sufficient to controvert charges that he violated DR 9-102 which concerns attorneys' fiduciary and recordkeeping responsibilities (see, *Matter of Harris*, 124 AD2d 126, 511 NYS2d 918; *Matter of Iversen*, 51

> AD2d 422, 381 NYS2d 711), it did give rise to a question as to whether respondent violated DR 1-102(A)(4) which was cited by the Committee and has been held to require a showing of intent to defraud, deceive or misrepresent (*Matter of Altomerianos*, 160 AD2d 96, 559 NYS2d 711).[5]

The principle of *Altomerianos* has been followed without reservation or distinction. In its 1993 decision in *Matter of Klugerman* the court, imposing a two-year suspension, confirmed the hearing panel's finding that "respondent acted without venal intent" and noted further that therefore a finding that respondent had violated DR 1-102(A) (4) should be disaffirmed:

> The report should be confirmed to the extent indicated above, and disaffirmed solely to the extent that it was concluded that respondent's actions violated DR 1-102(A)(4), which we have held should be reserved for fraudulent conduct (*Matter of Altomerianos*, 160 AD2d 96, 102, 559 NYS2d 712; *Matter of Altschuler*, 139 AD2d 311, 531 NYS2d 91).[6]

In *Klugerman*, the attorney received certain collection deposits and placed them in his regular account, the balance of which fell below the amount required. The panel found a technical conversation under DR 1-102(A)(6)(now (8), but as noted above failed to find that the respondent acted with venal intent.[7]

In its 1995 decision the Appellate Division, Second Department, in *Matter of Slavin*, although finding the respondent guilty of a violation of DR 1-102(A)(4) based upon his commingling of escrow funds with personal funds, the court noted that it did not appear that the attorney used any of the funds for his own purposes. A censure was rendered based upon the respondent's fifty years of practice without prior discipline.[8]

Based upon the above it should, be apparent that in most cases the consequence for conversion of clients' funds, upon proof of venal intent, is disbarment. That notwithstanding, it is gratifying to see consistency in the venal intent requirement so that in cases where lawyers lack such venality the mere proof of an absence of funds in their special accounts alone is insufficient to warrant the extreme sanction of disbarment.

Although a lack of venality or substantial mitigating circumstances may result in a lesser sanction, running the risk of either will only result in devastating consequences for the attorney. Therefore the moral is that:

No matter how low the cash flow may go, borrowing from the escrow, is always a huge no-no.

~

Published: New York Law Journal, “Outside Counsel”,
May 22, 1997

---

1 Checks returned against an attorney's special trust account are by law reported initially to the Lawyer's Fund for Client Protection and ultimately to the appropriate attorney Disciplinary Committee (22 NYCRR 1300). Moreover, although the First and Second Departments maintain rules permitting the random audit of financial records of attorney special accounts (22 NYCRR 603.15, 691.12), upon information and belief those rules have not been fully implemented due to a lack of appropriate funding.

2 *Matter of McLaughlin*, 158 AD2d 12, 556 NYS2d 609 (First Dept-1990) [Respondent deposited escrow funds to his business account and permitted balance to fall below required amount]; *Matter of Pollack*, 142 AD2d 382; 536 NYS2d 435 (First Dept-1989) [court recognized that only unintentional conduct would justify a sanction less than disbarment] in *Matter of Levine*, 101 AD2d 49, (First Dept-1984) [court acknowledged that the "disabling effects of mental or physical incapacitation. . . (and) . . . a long unblemished record. . . without permanent loss to the client, would be recognized as factors in mitigation (id. at 509)]; *Matter of Pinello*, 100 AD2d 64, (First Dept-1984):

> This court has consistently imposed the penalty of disbarment where an attorney has converted the escrow funds of a client or a third party. (*Matter of Borsher*, 93 A.D.2d 322; *Matter of Warfman*, 91 A.D.2d 356; Matter of Nadel, 85 A.D.2d 8; *Matter of Field*, 79 A.D.2d 198, 436 N.Y.S.2d 920; *Matter of Stults*, 77 A.D.2d 254, mot. for lv. to app. den. 53 N.Y.2d 606, 440 N.Y.S.2d 1026; *Matter of Wolf*, 73 A.D.2d 419; and *Matter of Marks*, 72 A.D.2d 399). Whenever an attorney misappropriates funds from a client, faith in the legal profession is thereby eroded. A lawyer who steals from a client and thus violates the sacred trust reposed in him, should forfeit the right and the privilege to practice law. Only the ultimate punishment of disbarment can properly express our abhorrence for such conduct, protect the

public and maintain confidence in the integrity of the legal profession.

Supra at page 7.

3 *Matter of Altschuler*, 139 AD2d 311, 313, 314, 531 NYS2d 91 (First Dept.-1988) [two-year suspension--Respondent's conversion was not venal and therefore did not violated DR 1-102(A) (4)]; *Matter of Weisman*, 139 AD2d 249, 531 NYS2d 255 (First Dept-1988) [two-year suspension~-Respondent who deposited funds in non-escrow account and permitted balance to fall below required amount, had clean record and full cooperated with the Disciplinary Committee]; *Matter of Winston*, 137 AD2d 385, 528 NYS2d 843 (First Dept-1988) [three-year suspension--Respondent's conversion was caused by cocaine induced mental illness]; *Matter of Morrison*, 137 AD2d 70, 527 NYS2d 792, 794 (First Dept.-1988) [two-year suspension--Respondent acted carelessly but without venality]; *Matter of Black*, 103 AD2d 462, 480 NYS2d 471 (First Dept-1984) [two-year suspension--shortage in Respondent's account resulted initially from an improper IRS levy]; *Matter of O'Hare*, 103 AD2d 191, 192, 479 NYS2d 74 (Second Dept-1984) [three-year suspension--respondent's conversion was more in form than substance and resulted in no harm to the client]; *Matter of Caplan*, 101 AD2d 473, 476 NYS2d S (Second Dept-1984) [one-year suspension--Respondent's mitigation included a clean record and very serious personal problems] *Matter of Rogers*, 94 AD2d 121, 463 NYS2d 458 (First Dept-1983) [although Respondent's conduct was negligent rather than intentional, he neverthele~5 converted funds in violation of DR 1 lO2(A) (4); *Matter of Iverson*, 5l AD2d422, 423, 424 (Fourth Dept-1976) ["The conversion is complete when the account in which the client's funds are deposited is less than the client's interest in it, and the conduct of the attorney is not excused because the improper handling of the funds is due to mismanagement rather than misconduct"].

4 22 NYCRR 1200.1(i), cited with approval by the Appellate Division, First Department, in *Matter of Altomerianos*, 160 AD2d 96,559 NYS2d 713,716 (1990).

5 79 NY2d 520, 524; 583 NYS2d 949 (1992).

6 189 AD2d 284; See also: *Matter of Rivera*, ___ AD2d ___ 645 NYS2d 13 (First Dept-1997); *Matter of Ampel*, 208 AD2d, 57, 60, 624 NYS2d 116 (First Dept-199S); *Matter of Pelsinger*, 190 AD2d 158, 161 (First Dept-1993).

7 DR 1-102(8) "a lawyer shall not engage in any other conduct adversely reflecting on the lawyer's fitness to practice law."

8 208 AD2d 86, 622 NYS2d 747.