

Advisory Opinion 2000-1

No. 2000-1; Use of Credit Cards to Fund Trust Account Retainer Deposits

Facts

The inquiring lawyer accepts payment by credit card for services rendered, including fees, expenses and tax. Credit-card lenders deduct a processing fee before crediting the balance to the lawyer's credit-card account at his bank. The processing fee is about 3 percent of the total payment. The lawyer absorbs this fee and does not bill it back to clients.

The lawyer now proposes to accept payment by credit card to fund client retainer deposits in trust. The deposits would be drawn down to pay future fees, expenses and tax as they came due.

The mechanics of the specific proposal are as follows. Retainer proceeds, less the processing fee, would be credited to the lawyer's credit-card account. Upon receiving credit in the credit-card account, the lawyer would deposit to his regular client trust account the gross amount charged, as if there were no processing fee deduction. To accomplish that, the lawyer would make up the amount of the processing fee from his own funds. For example, if the client funded a \$1,000 retainer deposit by credit card and the credit-card lender credited the lawyer's credit-card account with a net of \$970 after deducting \$30 (3 percent) as a processing fee, the lawyer would deposit \$1,000 to his regular trust account, making up the \$30 processing fee out of his own funds.

Question Presented

Does the proposed use of credit cards to fund retainer deposits in trust comport with the New Mexico Rules of Professional Conduct, Rules 16-101 to 16-805 NMRA 2000?

Summary Conclusion

No.

Limited Scope of Opinion

This opinion does not address fact situations substantially different from those described. For example, this opinion does not address the propriety of accepting credit-card payments for legal services generally. A number of considerations involved in an analysis of that general issue are not considered here. Conversely, considerations and conclusions involved here are not necessarily relevant to the general issue.

Analysis

In responding to this question, the committee discussed credit-card processing and available processing options with a knowledgeable individual from the New Mexico offices of a major national banking association which is a MasterCard and Visa issuer.

At least two provisions of the New Mexico Rules of Professional Conduct are implicated by the specific proposal. Rule 16-108(E) prohibits a lawyer from providing financial assistance to clients in connection with pending or contemplated litigation, with exceptions which do not appear relevant here. Rule 16-115 lays down general rules for safekeeping property of others. As relevant here, Rule 16-115(A) requires money of others to be kept "in a separate account." We begin with a discussion of the latter Rule.

While Rule 16-115(A) requires only that funds of clients or third persons "be kept in a separate account"--i.e., separate from the lawyer's business and personal accounts--the ABA comment makes clear that such money is to be held "in one or more trust accounts." Thus any money credited by a credit-card lender as a trust deposit must be credited directly to a trust account. Accordingly, the credit-card account to which retainer deposits are credited would have to be set up as a client trust account. If this cannot be arranged, a violation of Rule 16-115(A) would occur.

Assuming the foregoing issue can be resolved does not end the committee's concerns, however. The committee is concerned that such a credit card trust account may be accessed by third parties--specifically, credit-card lenders and processors. The issue arises in connection with "charge-backs." For example, Client A charges a \$1,000 trust deposit to his credit card. The lawyer nets \$970 (after deduction of the 3 percent processing fee). The lawyer then transfers that \$970, plus the \$30 processing fee deduction from his own pocket, and deposits \$1,000 in his regular client trust account. The following month, the lawyer draws down the entire \$1,000 to pay incurred fees and expenses. As a result, none of Client A's funds remain in trust. Some time later, Client B similarly makes a credit-card trust deposit in the amount of \$1,000. The net from Client B's deposit in the credit-card trust account should thus be \$970 (assuming the same 3 percent processing fee applies). But in fact, no balance appears in that account because Client A, dissatisfied for whatever reason, has notified his credit-card lender that he disputes the lawyer's bill. When this happens the lender automatically charges back the \$970 to the account to which it was originally credited. The result is that the \$970 debit from Client A's charge-back is offset against the \$970 credit from Client B's subsequent transaction. The net is 0. At this point, the lawyer finds himself in violation of Rule 16-115, because the lawyer's disputed payments from Client A have become commingled with (and refunded using) Client B's trust deposit.

This problem could be viewed as a merely "technical" violation of the Rule. However, the committee foresees real problems of exactly the types Rule 115 was intended to forestall. For example, the most likely "fix" for the situation would probably be for the lawyer to fund Client B's trust deposit with his own check for \$1,000 deposited into the regular client trust account. The most obvious problem with this approach is that the lawyer hasn't actually received any money from Client B, resulting in a potential violation of Rule 16-108(E)--at least if the trust deposits relate to pending or contemplated litigation. Even if it can be argued that the lawyer has constructively received Client B's deposit, that doesn't solve the Rule 115 commingling violation because, for at least some period of time, Client B's trust deposit is in the lawyer's "pocket," subject to liens and other claims of the lawyer's creditors. Further, the lawyer may lack sufficient funds to replace the trust deposit--particularly if a bankruptcy has intervened or if the amount to be funded/reimbursed is more substantial than the lawyer's current bank balance.

One solution to charge-backs, suggested by another state's bar association, is for lawyers to negotiate non-recourse agreements. While this would indeed solve this particular problem, we are told this solution is unrealistic. There are hundreds if not thousands of different credit-card issuers/lenders.

Credit-card processors are fewer in number, but their function is purely ministerial. We are told that no credit-card processor would accept the risk of non-payment. In addition, some committee members suggest that non-recourse agreements may not be consistent with federal law governing credit cards.

We are also told that some credit-card processors will agree to deduct charge-backs from a different account from the account to which credits are made. However, if the charge-back account has insufficient funds or is simply unavailable--e.g., in the case of the lawyer's bankruptcy--the credit-card processor (and lender) will then offset the charge-back against any available credits. In that case, Client B's trust deposit credit will still be used to cover Client A's charge-back.

The committee is uncertain how to evaluate the inquiring lawyer's proposal to supplement the net amount credited by the amount of the processing fee. One way to look at this is to view the processing fee as a collection cost amounting to a normal business expense. That approach seems valid where the client is paying a bill for fees and services already rendered. In that situation, the processing fee is clearly a collection cost, because money is due. Further, the lawyer's own funds are not being used to supplement the client's net payment.

The collection-cost characterization is less persuasive, however, in the context of retainer deposits intended to satisfy a client's future payment obligations. In that context, the lawyer is supplementing the client's net trust deposit with his own funds. Here the proposal begins to look like the financial assistance prohibited by Rule 16-108--at least where a pending or contemplated litigation is involved. In addition, a lender will only reverse the net amount of charge-backs--i.e., \$970 in the foregoing example. At that point the \$30 supplementation in the regular trust account now belongs to--whom? Probably the lawyer since the credit-card lender has credited the client with the full \$1,000 charged to the credit card. But since the \$30 was deposited in the client's name, can the lawyer properly withdraw it? And aren't his funds now commingled with his clients' funds in the trust account? Finally, there is an issue as to how to properly account for the \$30 supplementation under Rule 17-204(A)(1) and (2).

The committee does not think the supplementation issue, standing alone, is necessarily controlling. But in connection with the other concerns discussed above, it lends weight to the committee's conclusion.

Committee's Consensus Conclusion/Alternative Approaches

The committee thinks the lawyer would be ill-advised to accept direct credit-card payments for retainer deposits to be held in trust. The committee's fundamental concerns stem from the possibilities for failure to maintain the required separation of the lawyer's funds from his clients,' in potential violation of Rule 16-115.

The committee suggests there are other, potentially less troublesome ways clients can make retainer deposits using credit cards. One alternative is credit-card checks. Many credit-card issuers/lenders supply checks which can be written against credit card accounts. The client can write such a check to the lawyer for deposit directly into the lawyer's regular client trust account. Alternatively, the client can obtain a cash advance on his or her credit card, and use the proceeds to fund the retainer deposit. Through either of these methods, the lawyer receives the full retainer amount for deposit directly into his regular client trust account, and avoids the problems discussed above. Clients will, of course, incur somewhat more expense because cash advances typically carry cash-advance charges; in effect, the processing fee for cash advances is borne by credit-card holders rather than the payee lawyer.