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IN THE SUPREME COURT OF THE STATE OF HAWAI‘I

In the Matter of the
HAWAI‘I RULES GOVERNING TRUST ACCOUNTING

ORDER AMENDING HAWAI‘I RULES
GOVERNING TRUST ACCOUNTING

(By: Recktenwald, C.J., Nakayama, Acoba, McKenna, and Pollack, JJ.)

IT IS HEREBY ORDERED that the Hawai‘i Rules Governing Trust Accounting, are amended, effective January 1, 2014, as follows (deleted material is bracketed and stricken; new material is underscored):

[Section H]Rule 1. [AUTHORITY] PURPOSE AND SCOPE.

~~[These Rules Governing Trust Accounts are promulgated pursuant to Rule 11(f)(2) of the Rules of the Supreme Court of Hawai‘i (“Rule 11”).] These Rules describe the minimum trust accounting records to be maintained and the minimum trust procedures to be followed by all participants in the Trust Account Program.~~

[Section H]Rule 2. [PURPOSE]RESERVED.

~~[These Rules describe the minimum trust accounting records to be maintained and the minimum trust procedures to be followed by all participants in the Trust Account Program.]~~

[Section HH]Rule 3. APPLICABILITY.

These Rules apply to all attorneys and law firms which receive client funds that, under Rule 11 of the Rules of the Supreme Court of the State of Hawai‘i, must be deposited in a Trust Account.

~~[Section IV]~~ Rule 4. TRUST ACCOUNT REGULATIONS AND MINIMUM TRUST ACCOUNTING RECORDS.

(a) A lawyer in possession of any funds or other property belonging to a client or third person, where such possession is incident to the lawyer's practice of law, is a fiduciary and shall not commingle such funds or property with his or her own or misappropriate such funds or property to his or her own use and benefit. In keeping with that fiduciary duty, all client funds paid to an attorney or law firm, including advances for costs and expenses, shall be deposited and maintained in one or more identifiable client trust accounts established pursuant to Rule 11 of the Rules of the Supreme Court of the State of Hawai'i. No funds belonging to the attorney or law firm shall be deposited or maintained in a client trust account except

(1) funds reasonably sufficient to either pay bank charges or avoid paying bank charges on the account or to cover unanticipated overages, and

(2) funds belonging in part to a client and in part presently or potentially to the attorney, though such funds shall be withdrawn promptly by the attorney when earned or upon resolution of any dispute over ownership of said funds, to avoid commingling of attorney and client funds.

Such client trust accounts shall be kept in Hawai'i in accordance with Rule 11 of the Rules of the Supreme Court of the State of Hawai'i and Rule 1.15 of the Hawai'i Rules of Professional Conduct, and in the lawyer's name, in the name of a partnership of lawyers, or in the name of the professional corporation of which the lawyer is a member, and each trust account, as well as deposit slips and checks drawn thereon, shall be prominently labeled "client trust account." All funds entrusted to a lawyer shall be deposited intact into the trust account. All fees, except availability fees, shall be maintained in trust until earned and are refundable until earned, but must be withdrawn by the attorney as earned to avoid commingling. All earned client funds shall be transferred to the attorney's or law firm's business account in a manner which allows records of such transfers to maintained pursuant to Rules 4(c) and (d) of this Rule

(b) All trust account withdrawals shall be made only by authorized electronic bank transfer or by check payable to a named payee and not to cash. Only an attorney admitted to practice law in this state shall be an authorized signatory on a client trust account. Earned fees withdrawn from a trust account shall be distributed by check or authorized electronic transfer only to the named lawyer, law partnership, or professional law corporation. No personal or non-client business expenses of the lawyer, law partnership, or professional law corporation shall be paid directly from the trust account.

(c) Every attorney and law firm who practices in this jurisdiction and ~~[that]~~ maintains a ~~[F]~~trust ~~[A]~~account shall maintain complete current financial records of the account for at least ~~[six]~~6~~[y]~~ years after ~~[(1)]~~either completion of the employment to which they relate, or ~~[(2)]~~ the last transaction on the account, whichever occurs last. ~~[All such records shall comply with Disciplinary Rule 9-102(b) and Addendum A to the Code of Professional Responsibility.^(†)]~~

[†] ~~Editor's note: The Code of Professional Responsibility and its Disciplinary Rules were repealed and replaced by the Hawai'i Rules of~~

Professional Conduct (HRPC). See now HRPC Rule
1.15(f).]

Such records shall include:

(1) Receipt and disbursement journals containing a record of deposits to and withdrawals from bank accounts which concern or affect the lawyer's practice of law, including a practice's business accounts, specifically identifying check numbers, and the date, source, and description of each item deposited, and the date, payee, and purpose of each disbursement;

(2) Ledger records for all trust accounts required by this Rule showing, for each separate trust client or beneficiary, the source of all funds deposited, the names of all persons for whom the funds are or were held, the amount of such funds, the descriptions and amounts of charges or withdrawals, relevant check numbers, and the names of all persons or entities to whom such funds were disbursed;

(3) Copies of retainer and compensation agreements with clients as required by this Rule;

(4) Copies of accountings to clients or third persons showing the disbursement of funds to them or on their behalf;

(5) Copies of bills for legal fees and expenses rendered to clients;

(6) Copies of records showing disbursements on behalf of clients;

(7) The physical or electronic equivalents of all checkbook registers or check stubs, bank statements, records of deposit (which shall be sufficiently detailed to identify each item), prenumbered canceled checks or their equivalent which clearly bear the legend "client trust account," and substitute checks provided by the institution;

(8) Copies of all monthly trust account reconciliations and all records showing, at least quarterly, a listing of all clients for whom the lawyer holds money in any client trust account, with each client's related balance, the grand total of which equals the reconciled trust account balance on the bank statement covering the same period;

(9) Records of all electronic transfers from client trust accounts, including the name of the person authorizing the transfer, the date of the transfer, the name of the recipient and confirmation from the financial institution of the trust account number from which money was withdrawn and the date and time the transfer was completed; and

(10) Copies of those portions of clients' files that are reasonably necessary for an understanding of the financial transactions pertaining to them.

(d) Records required by these Rules may be maintained by electronic, photographic, computer, or other media, provided that they otherwise comply with these Rules and provided further that printed copies can be produced. If maintained electronically, the records shall be backed-up on a regular and frequent basis. The financial books and other records required by these Rules shall be maintained on a cash method consistently applied from year to year. All records, including bookkeeping records, if stored in a physical form, shall be located at the principal Hawai'i office of each lawyer, law partnership, or professional law corporation or in a readily accessible location, or, if stored electronically, shall be readily available, and shall be available for inspection,

review for compliance with these Rules, and copying at that location by a duly authorized representative of the Office of Disciplinary Counsel.

(e) Upon dissolution of any partnership of lawyers or any legal professional corporation or other entity, the partners, shareholders, or other principals shall make appropriate arrangements for the maintenance of the records specified in paragraph (c), above. Upon the sale of a law practice, the seller shall make appropriate arrangements for the maintenance of the records specified in paragraph (c), above.

COMMENT:

[1] Rule 4 of these Rules enumerates the basic financial records that a lawyer must maintain with regard to the business and trust accounts of a law firm. These include the standard books of account and the supporting records that are necessary to safeguard and account for the receipt and disbursement of client funds as required by these Rules. These records shall be maintained by the lawyer for a period of 6 years after termination of each particular legal engagement or representation, or the last transaction on the account, whichever occurs later.

[2] Rule 4(b) enumerates minimal accounting controls for client trust accounts. It also enunciates the requirement that only a lawyer admitted to the practice of law in the jurisdiction shall be the authorized signatory or authorize electronic transfers from a client trust account. The lawyer has a non-delegable duty to protect and preserve the funds in a client trust account and can be disciplined for failure to supervise subordinates who misappropriate client funds. See Rules 5.1 and 5.3 of the Hawai'i Rules of Professional Conduct.

[3] Authorized electronic transfers shall be limited to (1) money required for payment to a client or third person on behalf of a client, (2) expenses properly incurred on behalf of a client, such as filing fees or payment to third persons for services rendered in connection with the representation, or (3) money transferred to the lawyer for fees that are earned in connection with the representation and are not in dispute; or (4) money transferred from one client trust account to another client trust account.

The requirement in paragraph (a) that receipts shall be deposited intact mean that a lawyer cannot deposit one check or negotiable instrument into two or more accounts at the same time, a practice commonly known as a split deposit.

[4] Rule 4(c)(7) of these Rules requires that the physical or electronic equivalents of all checkbook registers, bank statements, records of deposit, pre-numbered canceled checks or check stubs, and substitute checks be maintained for a period of 6 years after termination of each legal engagement or representation, or the last transaction on the account, whichever

occurs later. The “Check Clearing for the 21st Century Act” or “Check 21 Act”, codified at 12 U.S.C. §5001 et. seq., recognizes “substitute checks” as the legal equivalent of an original check. A “substitute check” is defined at 12 U.S.C. §5002(16) as “paper reproduction of the original check that contains an image of the front and back of the original check; bears a magnetic ink character recognition (MICR) line containing all the information appearing on the MICR line of the original check; conforms with generally applicable industry standards for substitute checks; and is suitable for automated processing in the same manner as the original check.” Banks, as defined in 12 U.S.C. §5002(2), are not required to return to customers the original canceled checks. Most banks now provide electronic images of checks to customers who have access to their accounts on internet-based websites. It is the lawyer’s responsibility to download electronic images. Electronic images shall be maintained for the requisite number of years and shall be readily available for printing upon request or shall be printed and maintained for the requisite number of years.

[5] The ACH (Automated Clearing House) Network is an electronic funds transfer or payment system that primarily provides for the inter-bank clearing of electronic payments between originating and receiving participating financial institutions. ACH transactions are payment instructions to either debit or credit a deposit account. ACH payments are used in a variety of payment environments including bill payments, business-to-business payments, and government payments (e.g. tax refunds.) In addition to the primary use of ACH transactions, retailers and third parties use the ACH system for other types of transactions, including electronic check conversion (ECC). ECC is the process of transmitting encoded information from the bottom of a check and converting check payments to ACH transactions, depending upon the authorization given by the account holder at the point-of-purchase. In this type of transaction, the lawyer should be careful to comply with the requirements of Rule 4(c)(9) of these Rules.

[6] There are 5 types of check conversions where a lawyer should be careful to comply with the requirements of Rule 4(c)(9) of these Rules . First, in a “point-of-purchase conversion,” a paper check is converted into a debit at the point of purchase and the paper check is returned to the issuer. Second, in a “back-office conversion,” a paper check is presented at the point of purchase and is later converted into a debit and the paper check is destroyed. Third, in an “account-receivable conversion,” a paper check is converted into a debit and the paper check is destroyed. Fourth, in a “telephone-initiated debit” or “check-by-phone” conversion, bank account

information is provided via the telephone and the information is converted to a debit. Fifth, in a “web-initiated debit,” an electronic payment is initiated through a secure web environment. Rule 4(c)(9) of these Rules applies to each of the type of electronic funds transfers described. All electronic funds transfers shall be recorded and a lawyer should not re-use a check number which has been previously used in an electronic transfer transaction.

[7] The potential of these records to serve as safeguards is realized only if the procedures set forth in Rule 4(c)(8) of these Rules are regularly performed. The trial balance is the sum of balances of each client's ledger card (or the computerized equivalent). Its value lies in comparing it on a monthly basis to a control balance. The control balance starts with the previous month's balance, then adds receipts from the Trust Receipts Journal and subtracts disbursements from the Trust Disbursements Journal. Once the total matches the trial balance, the reconciliation readily follows by adding amounts of any outstanding checks and subtracting any deposits not credited by the bank at month's end. This balance should agree with the bank statement. Quarterly reconciliation is recommended only as a minimum requirement; monthly reconciliation is the preferred practice given the difficulty of identifying an error (whether by the lawyer or the bank) among three months' transactions.

[8] In some situations, documentation in addition to that listed in paragraphs (c)(1) through (c)(9) of Rule 4 is necessary for a complete understanding of a trust account transaction. The type of document that a lawyer must retain under paragraph Rule 4(c)(10) because it is “reasonably related” to a client trust transaction will vary depending on the nature of the transaction and the significance of the document in shedding light on the transaction. Examples of documents that typically must be retained under this paragraph include correspondence between the client and lawyer relating to a disagreement over fees or costs or the distribution of proceeds, settlement agreements contemplating payment of funds, settlement statements issued to the client, documentation relating to sharing litigation costs and attorney fees for subrogated claims, agreements for division of fees between lawyers, guarantees of payment to third parties out of proceeds recovered on behalf of a client, and copies of bills, receipts or correspondence related to any payments to third parties on behalf of a client (whether made from the client's funds or from the lawyer's funds advanced for the benefit of the client).

[9] Rule 4(d) allows the use of alternative media for the maintenance of client trust account records if printed or electronically transmittable copies of necessary reports can be

produced. If trust records are computerized, a system of regular and frequent (preferably daily) back-up procedures is essential. If a lawyer uses third-party electronic or internet-based file storage, the lawyer must make reasonable efforts to ensure that the company has in place, or will establish, reasonable procedures to protect the confidentiality of client information. See ABA Formal Ethics Opinion 398 (1995). Records required by Rule 4 of these Rules shall be readily accessible and shall be readily available to be produced upon request by the client or third person who has an interest as provided in Rule 1.15 of the Hawai'i Rules of Professional Conduct, or by the official request of the Office of Disciplinary Counsel, including but not limited to, a subpoena duces tecum. Personally identifying information in records produced upon request of the client or third person or by the Office of Disciplinary Counsel shall remain confidential and shall be disclosed only in a manner to ensure client confidentiality as otherwise required by law or court rule.

[10] Rule 4(e) provides for the preservation of a lawyer's client trust account records in the event of dissolution or sale of a law practice. Regardless of the arrangements the partners or shareholders make among themselves for maintenance of the client trust records, each partner may be held responsible for ensuring the availability of these records. For the purpose of these Rules, the terms "law firm," "partner," and "reasonable" are defined in accordance with Rules 1.0 (d), (g), and (i) of the Hawai'i Rules of Professional Conduct.

[Section V] Rule 5. MINIMUM TRUST ACCOUNT PROCEDURES.

Every attorney and law firm that maintains a [F]trust [A]account shall require periodic statements from the financial institution with respect to each such account no less than quarterly. Within [forty-five (45)] days of the receipt of each such statement, the attorney or law firm shall reconcile such statement with the books and records of the attorney or law firm. and] The attorney or law firm shall, within [sixty (60)] days of receipt of the statement, take steps to correct any discrepancies that may exist. In the event of a discrepancy between the financial institution's statement and the books and records of the attorney or law firm, records of the discrepancy and of the corrective action shall be maintained as part of the records required under Rule 4[Section IV] of these Rules.

COMMENT:

See Comment [7] to Rule 4 of these Rules for a description of the suggested procedures for reconciling the attorney's client trust account records with the account statements supplied by the financial institution maintaining the account.

~~[Section VI]~~ Rule 6. IMMEDIATE REPORTING OF CERTAIN DISCREPANCIES AND RETURNED CHECKS.

Every attorney and law firm shall, within ~~[ten-]~~10 working days after learning of either (~~[a]~~i) any discrepancy in any ~~[F]~~trust ~~[A]~~account which is in excess of ~~[ONE HUNDRED AND NO/100 DOLLARS-]~~(\$100.00) or (~~[b]~~ii) any ~~[F]~~trust ~~[A]~~account check being returned for insufficient funds, notify the ~~[Hawai'i Justice Foundation]~~Office of Disciplinary Counsel of the event. The notification shall be in writing, shall explain the event and its cause(s), if known, and shall be sent ~~[to the Foundation at 810 Richards Street, Suite 645, Honolulu, Hawai'i 96813,]~~ by certified mail. This requirement shall apply both to any ~~[F]~~trust ~~[A]~~account maintained by the attorney or law firm and to any ~~[F]~~trust ~~[A]~~account maintained by any other attorney or law firm of which an attorney has knowledge.

~~[Section VII]~~ Rule 7. ANNUAL CERTIFICATE AND REPORT.

As part of the annual attorney registration statement required by Rule 17(d) of the Rules of the Supreme Court of the State of Hawai'i, each~~[Every]~~ attorney ~~[and]~~or law firm shall file each year a certificate of annual compliance ~~[certifying that the attorney or law firm has complied]~~ with the trust accounting procedures and record keeping procedures of these Rules and Rule 1.15 of the Hawai'i Rules of Professional Conduct for the immediately preceding calendar year. The~~[Such]~~ certificate shall contain the name of the lawyer or law firm listed on the account, the trust account name, the trust account number, the financial institution's name and address, and the attorney's Bar number. All information contained in the certificate of compliance shall be provided electronically by the Hawai'i State Bar to the Hawai'i Justice Foundation and the Office of Disciplinary Counsel, and this information shall be kept confidential by all three organizations. The certificate shall be incorporated into the annual attorney registration statement and shall be in such form as prescribed by the ~~[Board of Directors of the Hawai'i State Bar- Association]~~ in consultation with the Hawai'i Justice Foundation and the Office of Disciplinary Counsel. The form shall be designed so as to minimize the burden and time required to complete it. In addition, the Office of Disciplinary Counsel~~[Hawai'i State Bar Association]~~ may monitor and/or supplement compliance and reporting by requiring the submission of more detailed ~~[F]~~trust ~~[A]~~account reports on a random, rotational and/or for-cause basis.

COMMENT:

Rule 7 reflects the requirements set forth in Rules 11(f)(1) and 17(d)(1) of the Rules of the Supreme Court of the State of Hawai'i which require every lawyer to annually certify, in connection with renewal of the lawyer's registration, either that the lawyer or law firm does not handle client funds and, therefore, is not required to maintain an IOLTA account or that the lawyer or law firm does receive and manage client funds, and maintains books and records in compliance with the requirements of these Rules and Rule 1.15 of the Hawai'i Rules of Professional Conduct.

~~[Section VIII]~~ **Rule 8. AUDIT.**

If a lawyer or law firm ~~[either (1)]~~ fails to file ~~[the]~~an annual Certificate and Report required by ~~[Section VII]~~Rule 7 of these ~~[Bylaws]~~Rules, the Hawai'i State Bar shall forthwith report that fact to the Office of Disciplinary Counsel. ~~[(2)]~~ If a lawyer or law firm discovers ~~[reports that]~~ a ~~[F]~~trust ~~[A]~~account check was dishonored for insufficient funds, ~~the lawyer or law firm [the Hawai'i Justice Foundation]~~ shall forthwith report that fact ~~[and supply a copy of the Certificate (if any)]~~ to the Hawai'i State Bar ~~[Association]~~ and the ~~[o]~~Office of ~~the~~ Disciplinary Counsel, which may order an audit of the ~~[F]~~trust ~~[A]~~account(s) involved at the cost of the attorney or law firm audited. If a lawyer or law firm fails to correct any violation of either Rule 11 ~~of the Rules of the Supreme Court of the State of Hawai'i~~ or these Rules within ~~[sixty (60)]~~ days after ~~[it]~~the violation is discovered through the audit process, or otherwise fails to comply with these Rules, the Hawai'i State Bar~~[Association]~~ shall refer the matter to the Office of Disciplinary Counsel. However, nothing in these Rules shall prevent or discourage any attorney from immediately reporting to the Office of Disciplinary Counsel any violation of ~~these Rules or the Hawai'i Rules of Professional Conduct [Code of Professional Responsibility]~~ involving a ~~[F]~~trust ~~[A]~~account.

As provided in Rule 11(f)(1) of the Rules of the Supreme Court of the State of Hawai'i, failure to provide certification within the registration period may result in administrative suspension from the practice of law in this jurisdiction in the manner provided in Rule 17(d)(4)(A) of the Rules of the Supreme Court of the State of Hawai'i.

~~[Section IX. — AMENDABILITY.]~~

~~These Rules may be amended by the Board of Directors of the Hawai'i State Bar Association at any time.]~~

DATED: Honolulu, Hawai'i, October 21, 2013.

/s/ Mark E. Recktenwald

/s/ Paula A. Nakayama

/s/ Simeon R. Acoba, Jr.

/s/ Sabrina S. McKenna

/s/ Richard W. Pollack

