



OFFICE
OF THE
PRESIDENT

100 SOUTH STREET • P.O. BOX 186 • HARRISBURG, PA 17108-0186 • (717) 238-6715 or (800) 932-0311 • FAX (717) 238-1204

KENNETH J. HOROHO, JR.

August 2, 2006

Elaine M. Bixler
Office of the Secretary
The Disciplinary Board of the Supreme Court of PA
First Floor, Two Lemoyne Drive
Lemoyne, PA 17043

Dear Ms. Bixler:

The Pennsylvania Bar Association Board of Governors met on Friday, July 28, 2006 and considered a recommendation from the PBA Real Property, Probate and Trust Law Section. The recommendation addressed the proposed amendments to the Rule 1.15 of the Pennsylvania Rules of Professional Conduct and Rule 221 of the Pennsylvania Rules of Disciplinary Enforcement.

After a thoughtful debate on these important issues, the Board voted to approve the enclosed recommendation. We thank the Disciplinary Board for extending the comment period so we had time to conduct a thorough review of the proposed amendments and offer comments. We look forward to working with you in the future.

Sincerely,

Kenneth J. Horoho, Jr.
President

KJHjr/slg
Enclosure

c: Andrew F. Susko, Esq.
C. Dale McClain, Esq.
William P. Carlucci, Esq.
Barry M. Simpson, Esq.
Gary G. Gentile, Esq.
Laurence H. Brown, Esq.
Daniel B. Evans, Esq.
Michael T. Shatto

Real Property, Probate and Trust Law Section Recommendation and Report on Proposed Amendments to Pa. R. Prof. Conduct 1.15

Recommendation

The Real Property, Probate and Trust Law Section recommends that the Pennsylvania Bar Association oppose the adoption of amendments to Pa. R. Prof. Conduct 1.15 and Pa. Rule of Disciplinary Enforcement 221 that would apply the reporting and investment requirements of those rules to funds or other property held by a lawyer as an executor, trustee, or other fiduciary, and that the opposition of the Association be communicated by the officers of the Association to the Disciplinary Board of the Supreme Court before the deadline for comments on August 10, 2006, and to other parties and officials as may be appropriate.

Report

The Disciplinary Board of the Supreme Court of Pennsylvania has proposed amendments to Pa. R. Prof. Conduct 1.15 and Pa. Rule of Disciplinary Enforcement 221 that would bring funds or other property held by lawyers as executors, trustees, or other fiduciaries within the scope of those rules. "Amendments to the Pennsylvania Rules of Professional Conduct and the Pennsylvania Rules of Disciplinary Enforcement Relating to Safekeeping Property and Funds of Clients and Third Persons--Mandatory Overdraft Notification," 36 Pa.B. 2801 (6/10/2006). The original deadline for written comments was July 3, 2006, but the deadline has been extended to August 10, 2006.

The proposed amendments are complex, would either conflict with or supersede provisions of the Pa. Probate, Estates, and Fiduciaries Code ("PEF Code"), would be uncertain in their application, would unduly restrict lawyers serving as fiduciaries, would not be effective in enforcing any fiduciary duties of lawyers serving as fiduciaries, and would needlessly complicate the administration of estates and trusts by lawyers serving as fiduciaries in Pennsylvania.

Summary of Amendments:

Under the proposed amendments, Rule 1.15 ("Safekeeping Property"), which currently applies only to property of a client or third party received "in connection with a client-lawyer relationship" would be extended to include property held by a lawyer "in a fiduciary capacity." This change (along with other related changes) would have the following consequences:

- Amended Rule 1.15(c) would require that a lawyer receiving property in a fiduciary capacity "promptly notify the client or third party."
- Amended Rule 1.15(c) would also require a lawyer receiving funds or other property in a fiduciary capacity to "promptly comply with applicable requirements of the Pennsylvania Probate Estate and Fiduciaries Code, the Pennsylvania Supreme Court Orphans' Court Rules, and applicable Orphans' Court Rules of the county which has jurisdiction of the matter."

- New Rule 1.15(k) would require that all funds held by a lawyer in a fiduciary capacity be invested either in a trust account “or in another investment which satisfies the requirements of the Prudent Investor Rule as set forth in the Pennsylvania Probate, Estates and Fiduciaries Code and this Rule.”
- Amended Rule of Disciplinary Enforcement 221 would require that lawyers serving as fiduciaries deposit “Fiduciary Funds” only in a “Eligible Institution.” An “Eligible Institution” is limited to banks, savings and loans, regulated investment companies and similar institutions that are authorized to do business in Pennsylvania (Rule 221(a)(2)) and have signed agreements with the Disciplinary Board under which they have agreed to promptly report overdrafts to the Lawyers Fund for Client Security Board (Rule 221(g)).

Problems with Amendments:

There are a number of fundamental policy problems with the proposed rules, as well as problems in interpretation and application. Some of the more significant problems include the following:

1. There are many ways in which the Rules of Professional Conduct could apply (or perhaps should apply) to lawyers whose clients have appointed them to serve as fiduciaries. For example, it would not be unreasonable to require that a lawyer accepting a fiduciary position should be competent to serve in that position (Rule 1.1), should exercise due diligence in carrying out fiduciary duties (Rule 1.3), should avoid conflicts of interest (Rules 1.7 through 1.10), and should be truthful in communications with beneficiaries and other third parties (Rule 4.1) and respectful of their rights (Rule 4.4). It might also be appropriate for lawyers to disclose in advance the fees they intend to charge as fiduciaries (Rule 1.5). However, the proposed amendments do not appear to address any of those issues, all of which are significant issues familiar to lawyers who have represented beneficiaries with grievances towards lawyers serving as fiduciaries. Instead, as explained below, the proposed rules appear to be addressing a problem which may not exist using a reporting procedure that may not be work.
2. Probably the most significant effect of the proposed amendments is that lawyers serving as fiduciaries would be required to keep “Fiduciary Funds” in a “Trust Account” at an “Eligible Institution.” This is a problem, for the following reasons:
 - a) The term “Fiduciary Funds” is defined broadly to cover *all* monies received by the fiduciary, which could mean that the lawyer as fiduciary could never invest in anything other than insured deposits and funds of regulated investment companies, and so could not invest in common stocks, bonds, or other common fiduciary investments, contrary to the rules enacted by the Pennsylvania legislature in the Prudent Investor Rule, 20 Pa.C.S. Chapter 72. (Although proposed Rule 1.15(k) refers to the Prudent Investor Rule, the reference is negated by the requirement that the lawyer comply with the PEF Code “and this Rule [1.15].” The words “and this Rule” are either meaningless or they restrict the lawyer-fiduciary to investments in interest-bearing “Trust Accounts.” However, if the words “and this Rule” are deleted, then the application of the entire Rule seems to become optional, because the Prudent Investor Rule does not prohibit any particular kind of investment and permits the retention of uninvested cash. The words “and this Rule” are therefore not merely

- a drafting error but reflect a fundamental problem in failing to express the purpose and effect of the intended changes.)
- b) The requirement of proposed Rule 1.15(k) that all “Fiduciary Funds” be invested does not contain any exception for small amounts of cash held for short periods of time, such as the exception for “Qualified Funds” as defined by proposed Rule 1.15(a)(8) or the exception for uninvested cash in the Prudent Investor Rule, 20 Pa.C.S. § 2707(a).
 - c) The application of these requirements to a lawyer serving as a co-fiduciary is uncertain and problematical. If the co-fiduciaries refuse to comply with Rule 1.15, is the lawyer-fiduciary exonerated or subject to discipline?
 - d) The purpose of these complex and uncertain amendments is not clear. Fiduciaries are already required to invest fiduciary funds in accordance with the Prudent Investor Rule, and fiduciaries are already prohibited from commingling fiduciary funds with their own funds or the funds of others. So the only substantive change that the proposed amendments would accomplish is the requirement that lawyers as fiduciaries keep uninvested cash in financial institutions that will report overdrafts. While the reporting of overdrafts may be helpful in discovering negligent or improper use of lawyer “Trust Accounts,” there is no reason to believe that overdrafts by lawyer-fiduciaries is a problem, or that reporting such overdrafts will uncover any fiduciary misconduct. (For example, it would be an extremely stupid lawyer who would write an overdraft from a fiduciary account from which the lawyer was embezzling funds.) The proposed change therefore seems to impose burdens on lawyers without any reason to believe that there will be any benefit to the public.
3. The new requirement in proposed Rule 1.15(c) that lawyers receiving funds in a fiduciary capacity “promptly notify the client or third person” is uncertain in its application.
 - a) To whom is notice given if the client is dead or has no legal or beneficial interest in the fiduciary funds? Must notice be given to every beneficiary (or possible beneficiary) of the funds? What about minor beneficiaries?
 - b) Must notices be sent of every receipt of funds, even for small amounts of income? Must notices be sent more frequently than monthly?
 - c) Pa. Orphans’ Court Rule 5.6 already requires notices of estate administrations and the PEF Code already contains provisions for the filing of inventories for estates (20 Pa.C.S. § 3101), accountings by personal representatives of estates (20 Pa.C.S. § 3501.1), new requirements for providing information to beneficiaries of trusts (20 Pa.C.S. § 7780.3, as added by Act 98 of 2006), and other provisions for accountings by other fiduciaries, and it is not clear whether proposed Rule 1.15(c) is meant to incorporate those requirements or supersede them.
 4. The incorporation by reference all of the requirements of the PEF Code into the disciplinary rules (proposed Rule 1.15(c)) raises the possibility that lawyers could be disciplined for relatively trivial violations of procedural requirements, while lawyers who commit serious breaches of fiduciary duties remain outside of the scope of the disciplinary rules. For example, the failure of a lawyer-executor to file an inventory with the Register of Wills (20 Pa.C.S. § 3301) could be viewed as a violation of Rule 1.15(c)

even if the beneficiaries of the estate have been fully informed, while an act of self-dealing might not violate any disciplinary rule at all because the general rule against acts of self-dealing by fiduciaries is based on common law and is not found within the PEF Code (although the new Uniform Trust Code provisions of the PEF Code, 20 Pa.C.S. §§ 7771 to 7780, added by Act 98 of 2006, do contain a codification of the fiduciary duties of trustees).

5. The proposed amendments make no distinction between lawyers serving in fiduciary capacities arising out of lawyer-client relationships and fiduciary capacities arising out of family or other non-professional relationships. For example, the proposed rules would apply even to a lawyer serving as the executor of a parent's estate when the lawyer is the sole beneficiary of the estate, and would apply to a lawyer serving as a custodian under the Uniform Transfers to Minors Act even when the custodial account was created by the lawyer with the lawyer's funds for the benefit of the lawyer's minor child.
6. To the extent that the proposed amendments either conflict with or supersede the provisions of the PEF Code that otherwise apply to fiduciaries, and purport to regulate the conduct of lawyers outside of any attorney-client relationship and outside of the performance of legal services, the amendments raise troubling constitutional and public policy issues, creating uncertainty and opportunities for both wasteful indecision and wasteful litigation.

For all of these reasons, it is recommended that the Pennsylvania Bar Association oppose the adoption of these changes to the Rules of Professional Conduct and Rules of Disciplinary Enforcement, and oppose any other efforts to subject lawyers serving as fiduciaries to any investment or reporting obligations different from those that apply to other fiduciaries.

This recommendation and report were approved by the Council of the Real Property, Probate and Trust Law Section on July 19, 2006.

Respectfully submitted,



Daniel B. Evans,
Chair

**Approved by the PBA Board of Governors on July 28, 2006
(This item was not forwarded to the House of Delegates since a position was needed prior to the date of the next meeting.)*