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Cautionary Tale:
Internet Scam Targeting Lawyer Trust Accounts

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> **Q: Why did you rob banks?**
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> **A: Because that's where the money is.**
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> **~Willie Sutton, Bank Robber (attributed)**

Unfortunately, criminals have learned that lawyers have money in their trust accounts. Moreover, the internet has increased the number, types and sophistication of the schemes targeting law firm trust accounts. Washington is not immune from this trend. In fact, the WSBA has a "scam alert" page on its web site compiling the latest frauds targeting law firms and including resources to combat them.[1]

In this column we'll look at a scam that has the potential to cause significant—and possibly uninsured—losses to law firms. Although variants of this particular scheme have been around for years, the electronic nature of today's practice makes unwary law firms especially vulnerable. We'll first outline the common pattern of the scam, flag its principal consequences and then turn to practical steps law firms can take to guard against it.

The Scam

A law firm receives an electronic inquiry from a new “Client” requesting that the firm collect on a debt—$250,000 in our example. The firm opens the matter and sends a collection letter to Debtor at an address supplied by Client. Debtor quickly forwards a cashier’s check satisfying the debt that the law firm deposits into its trust account. Client congratulates the firm for a job well done and asks the law firm to expedite transfer of the $250,000. The law firm reviews its trust account on-line and sees that the Bank has given it credit for the deposit. In the spirit of excellent service, the firm quickly wires the $250,000 to Client. Once it has wired the funds, the firm doesn’t hear further from the Client. Instead, two weeks later, Bank informs the firm that Debtor’s cashier’s check was uncollectible. Although the cashier’s check appeared to be on reputable bank, it was actually counterfeit. Because the firm had over $250,000 in its trust account that it was holding for other clients when it wired the money to Client, that money is gone. In effect, the criminals behind the scam used the firm to steal other clients’ money in the firm’s trust account.

Naturally, the firm’s other clients would like their money back. The firm contacts Bank. Bank asks the firm to read the fine print in its deposit agreement placing any responsibility for fraudulent transfers on the law firm. The law firm

then contacts its malpractice Carrier. Carrier asks the firm to read the fine print in its policy excluding trust account thefts from coverage. The deficit in the trust account also triggered an overdraft notification to the Bar Association.

Consequences

How could this happen?

RPC 1.15A underscores our basic duty of trust account administration in its title: "safeguarding property."[2] One of the ways we safeguard the funds of clients who, for example, have given us advance fee deposits or for whom we are holding the proceeds of a settlement is to make sure inbound checks have cleared before we write outbound checks on those same funds.

In our example, Bank had extended a provisional credit on the $250,000 deposit from Debtor's cashier's check even though the check had not yet "cleared" in the sense of collecting "good funds" from the bank on which the check was written. Granting a provisional credit is discretionary with the bank involved—but is often extended to business customers like law firms. Time periods for checks to clear—again, actually collecting the funds from the bank on which a check is written—vary due to many factors and are governed largely by the Federal Reserve rather than the RPCs—principally Regulation CC that addresses the availability of funds and collection of checks.[3] Here, Bank had

extended a provisional credit, but then revoked it when Debtor's check turned out to be counterfeit. By not waiting until Debtor's check had cleared, the law firm unwittingly transferred other clients' money to the criminals when it wired the $250,000 and, inevitably, the criminals—and the money—are long gone.

Although this kind of fraud could—and did—happen in "the old days,"[4] the internet has made law firm trust accounts more tempting targets for thieves.[5] Lawyers today in wide variety of practice areas only meet their clients "electronically" and, therefore, communicating solely by email is not unusual. It is also much easier today for thieves to learn about their targets—including which firms practice in areas where they might ordinarily have reasonably high balances in their trust accounts.

The financial consequences to a law firm can be severe. In *Bank of America NT & SA v. Hubert*, 153 Wn.2d 102, 120, 101 P.3d 409 (2004), for example, the Supreme Court concluded that a law firm—rather than its bank--bore the loss from a trust account theft because, in relevant part, the deposit agreement with its bank read: "'[Customer] shall be liable for any loss or damage to which your negligence contributed . . . Such liability includes instances when a current or former authorized representative effects one or more funds transfers to your detriment." Similarly, in *Stouffer & Knight v. Continental Casualty Company*,

96 Wn. App. 741, 982 P.2d 105 (1999), the Court of Appeals affirmed a malpractice insurance carrier's denial of coverage over the embezzlement of funds from a law firm trust account. Although both of these Washington examples involved "old fashioned" thefts, decisional law nationally suggests that more recent internet scams involving trust accounts risk the same results.[6] Beyond the immediate financial impact, loss of funds from a firm trust account—even when the lawyer is not a knowing participant—may result in regulatory discipline. In *Hubert*, for example, the Supreme Court noted that the lawyer involved stipulated to regulatory discipline over the theft involved even though he had not participated directly in the scheme.[7]

Safeguards

Scams like this suggest two practical risk management safeguards: vetting potential clients and taking a conservative approach to trust account disbursements.[8]

Vetting Potential Clients. In today's legal marketplace, it is not unusual for clients to locate lawyers through the internet or to communicate with them primarily through email or other electronic media. These changes in the way lawyers interact with potential clients, however, also put a premium on adequately vetting prospective clients. Standard risk management tools such as

conflict checks and engagement agreements should be used—along with possibly some research by the firm from readily available public sources on the prospective client. “Red flags” include initial communications to the firm along the line of “dear counselor” that appear to have targeted several firms in an effort to see which one “takes the bait,” client email addresses that are similar to legitimate companies but vary in small respects and debtors that pay with unusual speed.

Trust Account Disbursements. Federal Reserve Regulation CC does not specify a precise waiting period that automatically assures that a check has cleared. Firms need to be appropriately sensitive, therefore, to the distinction between “provisional credits” discussed earlier and checks that have “cleared” through the receipt of funds by the depositor’s bank from the check-writer’s bank. Particularly when the circumstances are similar to our example, law firms should prudently contact their banks to assure the receipt of “good funds” before issuing a corresponding disbursement from their trust accounts.

Although the focus of this column is on taking proactive steps to avoid becoming a victim of a scam, this same prudent approach to trust fund management can play an equally important role in everyday handling of routine trust account deposits and disbursements. A major source of trust account

overdrafts—and their potential regulatory and financial risks—occurs when lawyers simply assume they can issue disbursements because a corresponding deposit is shown on-line as being an available credit. Beyond scams, there are many mundane reasons why inbound checks may later be declared uncollectible by a law firm's bank—including insufficient funds in the check writer's account, the check writer stops payment or a technical reason the check cannot be processed such as a printing error involving the payor bank's routing number. Again, careful trust account management includes ensuring that inbound funds have actually been collected by the law firm's bank before disbursing those same funds.

Summing Up

Thefts targeting law firm trust accounts are not new. The internet, however, has magnified the threat significantly. In light of these new threats, we need to be wary—or we will be sorry.

ABOUT THE AUTHOR

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[1] https://www.wsba.org/for-the-public/scam-alert.

[2] RPC 1.15B addresses related trust account record requirements.

[3] An extended discussion of Regulation CC is available on the Federal Reserve's web site at: https://www.federalreserve.gov/paymentsystems/regcc-about.htm.

[4] *See* Sylvia E. Stevens, *Waiting for "Go" Dough*, 66 Or. St. B. Bull. 21 (June 2006) (discussing these issues in a more traditional context).

[5] *See Another Fake Check Scam Targeting Lawyers*, Va. Lawyers Weekly, June 17, 2019, available at www.valawyersweekly.com; Joanna Herzik, *Scams Continue to Target Texas Lawyers*, Texas Bar Blog, Nov. 14, 2019, available at www.texasbar.com; James Ash, *Scammers Target Labor Lawyers*, Florida Bar News, Sept. 1, 2018, available at www.floridabar.org.

[6] *See generally* New York City Bar Association Formal Op. 2015-3 (2015) at 1-2 (compiling cases nationally involving bank and coverage litigation over internet-based trust account thefts from law firms).

[7] 153 Wn.2d at 120; *see also In re Trejo*, 163 Wn.2d 701, 185 P.3d 1160 (2008) (lawyer disciplined for trust account violations when his secretary used firm trust account for check-kiting scheme).

[8] This is not intended to be an exclusive list of risk management steps. The New York City Bar opinion noted earlier—Formal Opinion 2015-3—surveys practical safeguards extensively as does an "ethics alert" from the California State Bar Committee on Professional Responsibility and Conduct issued in January 2011. Both are available on their respective web sites.