ETHICS ADVISORY OPINION

08-03

UPON THE REQUEST OF A MEMBER OF THE SOUTH CAROLINA BAR, THE ETHICS ADVISORY COMMITTEE HAS RENDERED THIS OPINION ON THE ETHICAL PROPRIETY OF THE INQUIRER'S CONTEMPLATED CONDUCT. THIS COMMITTEE HAS NO DISCIPLINARY AUTHORITY. LAWYER DISCIPLINE IS ADMINISTERED SOLELY BY THE SOUTH CAROLINA SUPREME COURT THROUGH ITS COMMISSION ON LAWYER CONDUCT.

Factual Background:

Client requests that lawyers act as escrow agent for some of client's real estate transactions for which lawyer is not closing agent. Lawyers have a pre-existing relationship with client/developer who purchases large tracts of land with purchase prices of up to $25 million. Although lawyers have a pre-existing relationship with client, lawyers are not equipped to handle and do not handle real estate closings. From time to time, lawyers may have represented client at a closing through a power-of-attorney.

The earnest money deposit typically ranges from $50,000 to $600,000. The earnest money deposits may be held in trust for periods ranging from several months to two years. The client has requested that the lawyers hold the earnest money deposits related to these transactions in interest-bearing accounts. Accordingly, the firm would hold money in a non-IOLTA, interest-bearing account from the time the contract is executed until the transaction is closed.

The cost of administering the non-IOLTA account in minimal. No service charges will be assessed if a balance of $1,500 is maintained; this balance will be maintained. Lawyers will charge a fee for holding the account of 0% to 3% of the amount deposited.

Question Presented:

May a law firm act as escrow agent for pre-existing client that is a real estate developer for whom firm will not serve as closing attorneys and deposit funds in non-IOLTA accounts when it is anticipated that funds will be held for several months to two years and in amounts of up to $25 million? (Interest will accrue at 1.5 percent, and the firm will charge holding fees of 0 to 3 percent.)

Summary:

Yes, the law firm may act as escrow agent and deposit funds in interest-bearing non-IOLTA accounts based on the facts presented.

Opinion:

Lawyers are routinely asked to serve as escrow agents to hold earnest money deposits in connection with real estate contracts. Lawyers serving in such a capacity must look to both Rule 1.15 of the South Carolina Rules of Professional Conduct ("SCRPC") and South Carolina Appellate Court Rule 412 (the "IOLTA Rule"). SCRPC Rule 1.15(a) requires the lawyers to keep such funds in a separate account and to maintain complete records of such funds for a period of six (6) years after termination of the representation. Other than those basic requirements of Rule 1.15(a), these facts do not raise any particular issues under Rule 1.15.

The IOLTA Rule establishes the general requirement that "all nominal or short-term" escrow funds held by lawyers must be deposited in IOLTA accounts. However, pursuant to Section (d) of Appellate Court Rule 412, if the lawyers reasonably determine that the escrow funds are not "nominal or short-term," the funds may not be deposited in an IOLTA account, but the funds may be deposited in a separate interest-bearing account, with the interest accruing for the benefit of the client or a third party.

Under these facts, based on the amount of funds, the rate of return, and the length of time the funds will likely be held, it is clear that the funds can earn income for the client in excess of the costs incurred to secure that income; hence, the lawyers may deposit the funds in an interest bearing non-IOLTA account. The lawyers should strongly consider requiring a written escrow agreement to define the scope of the arrangement and the responsibilities of the parties. The fact that the lawyers are not the closing attorneys is irrelevant.

The reference to the lawyers charging "holding fees" of 0 to 3 percent raises at least two issues that the lawyers should consider. First, under SCRPC Rule 1.5, the lawyers may not collect an unreasonable fee. The Committee notes that, under these facts, basing fees on a percentage of funds held may raise a question of reasonableness. Second, if the "holding fees" are such that they reduce the positive net return to the client to a nominal amount, then the determination of the reasonableness of using the non-IOLTA account becomes suspect.