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New Year's Resolution: Escheat Unclaimed Funds

By Barbara M. Seymour

It's Monday morning. You have cases on various trial dockets this week. You have four depositions in the next five days. Your paralegal is out with the flu. Your in-laws are coming to town this weekend. Just when you think you can't take any more, your bookkeeper calls with a quick question. The conversation goes something like this:

Bookkeeper: Do we have a formalized policy in place to address unclaimed property?

You: Um. Do what now?

Bookkeeper: I'm filling out this form from the Office of the State Treasurer.

You: Who? ... Why?

Bookkeeper: They're doing a routine audit of our trust account.

You: Wait ... What?

When you arrive at the office, you find a letter informing you that the State Treasurer "routinely contacts businesses and organizations to ensure they understand and are in compliance with the State's unclaimed property laws." You have been selected for what is called a "routine compliance review" and you have 15 days to complete a

questionnaire that asks, among other terrifying questions, whether you have any uncashed checks that have been outstanding for more than five years and whether you are familiar with the South Carolina Unclaimed Property Act. This article will explain a lawyer's obligations pursuant to the Unclaimed Property Act (UPA); describe the Unclaimed Property Program (UPP) and compliance review process conducted by the State Treasurer's Office (STO); and address the steps a lawyer should take to ensure compliance with both the UPA and the South Carolina Rules of Professional Conduct.

Application of the Unclaimed Property Act

The South Carolina Unclaimed Property Act applies to any business or organization (a Holder) that is in possession of property that belongs to someone else (the Owner). A Holder under the statute has several obligations:

(1) to review accounts on an annual basis to determine if they contain unclaimed funds;

- (2) to attempt to locate the Owners and deliver the unclaimed funds to them;
- (3) to report the names and last known addresses of Owners who have not been located; and
- (4) to escheat unclaimed funds based on a "dormancy period" established in the UPA.

Annual review of all accounts

A law firm has several accounts that are subject to the UPA, including the payroll account and the trust account. While this article will focus on issues related to client trust accounts, the general principles apply to other accounts as well. A lawyer must include all accounts that might hold funds that belong to someone else in the annual review.

The good news is that if you are compliant with the Supreme Court's Financial Recordkeeping Rule, Rule 417, SCACR, you are already complying with the annual review requirement set forth in the UPA, at least with regard to your client trust account. Rule 417 mandates that lawyers conduct month-

ly reconciliations of all client trust accounts. That process necessarily requires a review of outstanding transactions, including checks to clients and third parties. Additionally, Rule 1.15(d) of the Rules of Professional Conduct, Rule 407, SCACR, imposes an ethical obligation on lawyers to “promptly deliver funds received on behalf of clients and third parties.” If you are staying on top of outstanding checks by ensuring that they are timely delivered and negotiated in accordance with your ethical obligations, then your worries about the UPA are over. You have nothing to report and nothing to remit. It’s more likely, though, that there is unclaimed money somewhere that kicks in the next step in your firm’s obligations under the statute and your individual obligations under the conduct rules.

In connection with your monthly review of the trust account reconciliation, you should examine all outstanding disbursements more than a month old to determine how old they are and why they have not cleared. It could

be that a check was inadvertently left in the file and not mailed. Or, perhaps, it was returned in the mail or otherwise not delivered. Oftentimes, unclaimed funds are in small amounts, giving the payees little incentive to cash their checks. Regardless, the cause should be addressed and documented every month. This routine practice will go a long way to eliminate unclaimed funds issues in your trust account. Add to it the statutorily-mandated annual review and it is likely that funds will not linger long enough to trigger the statutory reporting and remittance requirements. The annual review should include two steps. First, you should attempt to contact the Owner of any unclaimed funds that have been dormant for a year or more. Second, you should review your records to determine if you are holding any funds that have been dormant for five years (for funds in the trust account) or one year (for wages) in accordance with the STO’s Report Conversion Table.

The STO recommends that

Holders conduct the “annual” review in June. The reason for this is simple: if you have funds to report and remit pursuant to the UPA, you are required to do so no later than November 1 each year. In addition, in most cases, you must make one last attempt to deliver the funds to the Owner within 120 days of reporting and remitting. If your routine is to notify clients and third parties of uncashed checks every year in June, you can ensure that dormant or abandoned funds are timely reported and remitted without having to take extra steps to comply with the due diligence requirement.

Locating owners and delivering funds

Due diligence in attempting to disburse funds from the trust account is mandated by both the UPA and the Rules of Professional Conduct. As with many other situations, the standard for conduct set by the ethics rules exceeds that mandated by statute. The UPA requires that a Holder attempt to locate the Owner of funds totaling \$50 or more. While a Holder must remit unclaimed funds in any amount to the STO under the Act, due diligence in attempting to locate an Owner prior to remittance is only required where the funds are equal to or greater than \$50. On the other hand, a lawyer’s ethical obligation to deliver funds to clients or third parties is not limited to a minimum amount. All funds must be accounted for and delivered promptly in accordance with the Rules of Professional Conduct, regardless of amount. Having said that, the Rules of Professional Conduct are rules of reason. A law firm must balance the resources expended on trying to locate the rightful owner of the funds against the amount in question. The most vexing of outstanding check is in a nominal amount that is too much trouble for the Owner to bother cashing. In such cases, a letter, telephone call or email to the reluctant Owner requesting that the check be cashed may be sufficient. Obviously, the larger the amount, the

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thank you for your leadership!*

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more effort a lawyer must make to persuade the Owner to negotiate the check. Regardless of the extent of your efforts to contact Owners, you must document them. It will become important—whether you face a disciplinary inquiry or a UPP compliance review—to have documented any returned mail, disconnected phone numbers and undelivered emails to demonstrate your due diligence.

Reporting and remitting abandoned funds

According to the dormancy schedule set forth in the UPA, the number of years after which property becomes “unclaimed” depends on the nature of the funds and the type of Holder. Funds held by law firms fall under the “Miscellaneous” category, which includes wages (one year) and “all other business property held in ordinary course of business” (five years). The reporting period is based on the date the check or other instrument was originally issued. For example, if you wrote a check from your trust

account between July 1, 2012, and June 30, 2013, and it has not been negotiated by the Owner, you are required to include that check in your 2018 report to the STO and to remit those funds by November 1 of this year.

Close attention must be paid to the dormancy schedule to ensure that you have time to conduct due diligence. As mentioned earlier, no more than 120 days prior to the reporting deadline, you are required to make one last attempt to deliver the funds to the Owner. The UPA requires written notice informing the Owner that you are in possession of property that has been deemed abandoned. The notice must state that you will remit the funds to the state as unclaimed if the Owner does not reply to your letter. The STO provides a downloadable sample Due Diligence Letter on its website for this purpose. Again, this statutory notice requirement only applies in cases where the funds total \$50 or more. In addition, this final notice is not mandated if you can demon-

strate that the last known address you have for the Owner is no longer valid. This is where an annual attempt to address outstanding disbursements can help reduce your law firm’s costs of compliance with the due diligence requirement.

If your final notice is unsuccessful or if a final notice is not required, you must then file your report and remit the funds. The STO requires that annual reports be filed by encrypted or password-protected email using a format established by the National Association of Unclaimed Property Administrators (NAUPA). Remittance can be made by check, ACH transfer or bank wire. The STO website and staff offer assistance in downloading the software necessary to file the annual report electronically and can answer any questions that you have about remittance.

Past due penalties and the Voluntary Disclosure Agreement

The UPA provides for the imposition of interest and penalties for failure to comply with the report-



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ing and remittance requirements. Section 27-18-360 sets forth a civil penalty of \$100 per day for failing to report, not to exceed a total of \$5,000. In addition, a failure to remit funds in accordance with the statute can result in a civil penalty of 25 percent of the value of the unclaimed funds. If anything in this article so far comes as a surprise to you and you have been in practice for more than five years, chances are good that you have funds in your trust account that should have been reported and remitted.

Fortunately, significant grace is afforded to unwary Holders by the STO. The goal is to bring businesses into compliance rather than impose harsh penalties for failing to comply. To that end, the STO offers a Voluntary Disclosure Program (VDP) for organizations holding unreported abandoned funds. If a law firm has not been notified of an upcoming unclaimed property audit and is not currently under an unclaimed property audit, it might be eligible to enter into a one-time Voluntary Disclosure Agreement (VDA) with the STO. Pursuant to such an agreement, the law firm would be required to do a number of things:

1. Submit a detailed plan for determining the extent of abandoned funds the firm is holding;
2. Submit an affidavit stating that amounts are estimates if the firm lacks adequate records;
3. Identify and report all unclaimed property for the prior 10 report years;
4. Conduct due diligence to attempt to deliver all unclaimed property being held;
5. Prepare and submit a written unclaimed property policy setting forth the law firm's procedure for ensuring future compliance; and
6. Pledge to fully comply with the UPA in the future.

The routine compliance review and UPP audit

A business that had not previously filed an unclaimed property report pursuant to the UPA or has gaps in its reporting history is given

priority by the UPP when selecting the target of a routine compliance review. The UPP staff at the STO reviews reporting history for companies located in South Carolina and identifies those that have either never reported before or appear to have lower reporting than would be expected given their size, industry and other factors. The STO estimates that about three to five percent of companies randomly reviewed are law firms. Lawyers should keep in mind that the purpose of this process is not to ferret out scofflaws and impose penalties, but rather to help organizations subject to the UPA with compliance. The notice from the STO will include several documents, including a two-page questionnaire, Frequently Asked Questions and a copy of the Dormancy Table.

The questionnaire is designed to help the STO determine the nature of your firm's accounts and bookkeeping practices; the amount and age of abandoned funds your firm might be holding; and the extent of your awareness of, and policies for, compliance with the UPA. The questionnaire must be completed, verified and returned to the STO within 15 days of the date of the notice letter. From there, the UPP staff will determine what further steps are necessary, which might include a UPP audit. If the UPP staff determines that an audit is appropriate, it will include an examination of your records for the previous 10 years. If an audit is performed and unreported unclaimed funds are discovered, the STO will issue a written demand for the delivery of those funds. Failure to comply is a misdemeanor and conviction could result in a significant fine or even jail time.

Before receipt of notice of the intent of the STO to conduct a UPP audit of your accounts, you have a window to explore whether you are eligible to enter into a Voluntary Disclosure Agreement. It is certainly recommended that a lawyer take advantage of the assistance of the STO staff and the VDA option in order to come into compliance in an attempt to avoid an audit and

the interest and penalties that are likely to result.

UPA compliance and client confidentiality

It goes without saying that all of the information contained in a law firm's trust account records are protected by the lawyer's confidentiality obligations set forth in the Rules of Professional Conduct. Rule 1.6(a), RPC, Rule 407, SCACR, makes it clear that "information related to the representation of a client" is confidential and may not be disclosed unless an exception set forth in that rule applies. Annual reporting pursuant to the UPA requires the disclosure of the names and addresses of the Owners of unclaimed property—information otherwise protected by client confidentiality.

To comply with a routine compliance review or UPP audit, the law firm might need to produce accounting records that necessarily contain information about fee arrangements and payment details; medical bills and other client obligations to third parties; settlement amounts—a whole host of otherwise protected data. Typically, the STO initially requests only general information about the firm and its procedures for identifying and reporting unclaimed property. No specific information about clients would be requested at that time. If it appears the firm might be in possession of reportable unclaimed property based on that initial analysis, the STO will determine the best audit approach and work cooperatively with the firm to carry out the examination. Again, the purpose is to educate the lawyer about the UPA requirements and to assist the firm in becoming compliant.

Whether you are filing your annual report, remitting unclaimed funds to the STO or participating in a routine compliance review, you are required to limit disclosure of client information as set forth in Rule 1.6, RPC. The first question a lawyer must ask in making any disclosure decision under Rule 1.6 is whether an exception to the confidentiality obligation applies. Rule

1.6(b)(7) provides that a lawyer may disclose information related to the representation of a client in order to comply with “other law.” Comment [15] states, in part, that “[W]hen disclosure of information relating to the representation appears to be required by other law, the lawyer must discuss the matter with the client to the extent required by Rule 1.4. If, however, the other law supersedes this Rule and requires disclosure, paragraph (b)(7) permits the lawyer to make such disclosures as are necessary to comply with the law.” Additionally, even if a full audit was opened, the STO would continue to work with your firm to preserve client confidentiality.

The best way to avoid having to deal with confidentiality issues and the UPA is to comply with the statute so that you never face a UPP routine compliance review or audit to begin with. If it is too late for that, consider a proactive approach and contact the STO about a VDA before they contact you. The Voluntary Disclosure Program

does not require the disclosure of any client information other than the identity of the Owners of unclaimed property and other information included on the unclaimed property report necessary for the STO attempt to get the money delivered to the people entitled to it.

Conclusion

In order to avoid a random compliance review or audit under the Unclaimed Property Program, a lawyer who has not reported unclaimed funds in the past 10 years should take the following action:

1. Review the STO website to learn more about reporting and remitting unclaimed funds.
2. Establish written procedures for monthly trust account reconciliation and review of uncleared checks in all law firm accounts.
3. Establish written procedures for annual due diligence and unclaimed property reporting.
4. Conduct a self-audit to review 10 years of records for all law firm accounts.

5. Contact the STO about the Voluntary Disclosure Program to avoid penalties for failing to report unclaimed funds in the past.

The South Carolina Uniform Unclaimed Property Act is not complicated, yet according to the State Treasurer’s Office, many lawyers are not familiar with it. Others are generally familiar with the existence of an unclaimed property law, but do not know how it specifically applies to them. STO auditors have found that most law firms have reportable unclaimed property. There are exceptions, but even very small law firms generally have at least some money in their trust accounts they have been unable to return to the Owners. Now is the time to put in place measures to identify abandoned funds, start the due diligence process and prepare for the November 1 reporting deadline.

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