1. Trust Money

DUTY TO ACCOUNT

When a solicitor receives money to be held on trust, the general law obligations of a trustee apply. The duties of a trustee which apply to a solicitor in relation to trust funds include:

- a duty to keep and render proper accounts and to give full information when required;
- a duty not to deal with the trust property for his/her own benefit, or otherwise to profit by the trust;
- a duty not to mix trust funds with his/her own funds or with other funds;
- a duty not to delegate his/her duties or powers.

In addition to these duties, in New South Wales a solicitor's obligations are regulated by statute. The Legal Profession Act 2004 (NSW) (the 'LPA') imposes the conditions to account for client's money and the Legal Profession Regulation 2005 (NSW) (the 'LPR') prescribes in detail how this should be done. The LPA and the LPR are based on a national core model. It is intended that a practitioner will find similar provisions on trust money and trust accounts in every other state's equivalent legislation.

In relation to the trust account, the prime part of the LPA is in Chapter 3, Part 3.1. Part 3.1 begins with s 242 and here we find the purposes of this Part:

a) to ensure trust money is held by law practices in a way that protects the interests of persons for or on whose behalf money is held, both inside and outside this jurisdiction,

(b) to minimise compliance requirements for law practices that provide legal services within and outside this jurisdiction,

(c) to ensure the Law Society Council can work effectively with corresponding authorities in other jurisdictions in relation to the regulation of trust money and trust accounts.

DEFINITION OF TRUST MONEY

Trust money is defined in s 243 of the LPA. According to s 243, trust money means money entrusted to a law practice in the course of or in connection with the provision of legal services by the practice and includes:

(a) money received by the practice on account of legal costs in advance of providing the services;

(b) controlled money received by the practice;

(c) transit money received by the practice; and

(d) money received by the practice, that is the subject of a power, exercisable by the practice or an associate of the practice, to deal with the money for or on behalf of another person.

This definition of trust money is not an exhaustive definition. The section specifically 'includes' four types of money that are trust money but does not limit itself to those categories. Note that money involved in financial services or investments is dealt with in LPA s 244 and is not trust money for the purposes of the LPA.

CATEGORIES OF TRUST MONEY

When a law practice has received trust money a decision must be made as to which type of trust money it is. The category of trust money will determine what is to be done with the money.

Under s 254 of the LPA certain trust money is to be deposited in a general trust account.

According to LPA s 254(1), subject to s 258A as soon as practicable after receiving trust money, a law practice must deposit the money in a general trust account unless:

(a) the practice has a written direction by an appropriate person to deal with it otherwise than by depositing it in the account; or

(b) the money is controlled money; or

(c) the money is transit money; or

(d) the money is to be dealt with under a power to receive or disburse money for or on behalf of another person exercisable jointly and severally with the other person or a nominee of the other person.

Subject to LPA s 258A, in those instances where the law practice receives money that is the subject of a written direction, it must deal with the money in accordance with that direction, within the period specified or if no period is specified, as soon as practicable after it is received. The law practice must keep a written direction mentioned in LPA s 254(1)(a) for the period prescribed by the regulations.

Section 255 of the LPA provides that a law practice must hold trust money

deposited in a general trust account of the practice exclusively for the person on whose behalf it is received, disburse the trust money only in accordance with a direction given by the person and account for the trust money as required by the regulations.

The keeping of trust records is dictated by LPA s 264. A law practice must keep in permanent form trust records in relation to trust money received by the practice. Those records must be kept:

(a) in accordance with the regulations;

(b) in a way that at all times discloses the true position in relation to trust money received for or on behalf of any person;

(c) in a way that enables the trust records to be conveniently and properly investigated or externally examined; and

(d) for a period determined in accordance with the regulations.

The aim of this section is to ensure that the law practice's accounting records at all times reflect the true position of each client's money.

General trust account

Section 253 of the LPA requires a law practice that receives trust money to which Part 3 of the LPA applies to maintain a general trust account in this jurisdiction in accordance with the regulations. This requirement does not apply however if the law practice receives only controlled money or transit money in a form other than cash.

General trust account money covers money entrusted to the law practice in the course of or connection with the provision of legal services including money received on account of legal costs in advance of providing the services. It is money which according to LPA s 254(1) must be deposited in a general trust account as soon as practicable after receiving it.

Written direction money

Written direction money was a new category of trust money introduced to NSW practitioners by the LPA in 2004. It is referred to in s 254(1)(a). Under LPA s 254(1)(a) a law practice is not required to pay this type of trust money into a general trust account. An exception to this is where the trust money is received in the form of cash. In s 258A we find:

- Trust money (other than controlled money and money that is the subject of a power) received in the form of cash must be deposited in a general trust account of the law practice concerned.

- If the law practice has a written direction by an appropriate person to deal with trust money referred to in subsection 258A(1) otherwise than by depositing it in a general trust account of the practice, the trust money must be deposited in the general trust account before it is otherwise dealt with in accordance with the direction, despite anything to the contrary in the direction.

It is important to know who is an appropriate person to make a written direction. Section 254(5) of the LPA defines an appropriate person for the purpose of the section as a person legally entitled to give the law practice directions in respect of dealings with the trust money. This might include a person who is not a client of the law practice.

The written direction must be kept in the trust records of the law practice for seven years after the finalisation of the matter to which it relates.

Controlled money

The third category of trust money is controlled money. Section 256 of the LPA deals specifically with controlled money and provides:

> (1) As soon as practicable after receiving controlled money, a law practice must deposit the money in the account specified in the written direction relating to the money.
>
> (2) The law practice must hold controlled money deposited in a controlled money account in accordance with subsection (1) exclusively for the person on whose behalf it was received.

If the controlled money is received in the form of cash there is no requirement to pay it into the general trust account before complying with the written direction (see LPA s 258A(3)).

The LPA has changed the way in which the receipt of controlled money is managed by a law practice. The first difference is that now a written direction for the controlled money must be obtained. Section 256 further provides that the law practice must maintain the controlled money account, and account for the controlled money, as required by the regulations. We will further examine controlled money in Chapter 8.

Transit money

Where a law practice receives money which is subject to instructions to pay or deliver it to a third party, this money is described as transit money.

Transit money is the fourth category of trust money referred to in LPA s 254(1)(c). The section of the Act which deals with transit money is s 257:

(1) Subject to s 258A, a law practice that has received transit money must pay or deliver the money as required by the instructions relating to the money:

(a) within the period (if any) specified in the instructions; or

(b) subject to paragraph (a), as soon as practicable after it is received.

(2) The law practice must account for the money as required by the regulations.

If transit money is received in the form of cash then it must first be paid into the general trust account (LPA s 258A).

In respect of transit money, a law practice must record and retain brief particulars sufficient to identify the relevant transaction and any purpose for which money was received (LPR cl 81(2)).

Although a transit money register is not specified, law practices keeping particulars of transit money on the client file to which the transit money relates will have to ensure that those particulars comply with LPR cl 81.

Trust money subject to a power

Where the trust money received by a law practice is to be dealt with under a power to receive or disburse money for or on behalf of another person exercisable jointly and severally with the other person or a nominee of the other person, there is no need to deposit this money to the general trust account (LPA s 254(1)). If the money is received in the form of cash however, s 258A(5) requires this money to be placed in the general trust account of the law practice (or a controlled money account in the case of controlled money), before dealing with it in accordance with the power.

The section of the LPA which deals with trust money subject to a power is s 258 and provides:

- Subject to s 258A, a law practice that exercises a power to deal with trust money must deal with the money only in accordance with the power relating to the money.
- The law practice must account for the money as required by the regulations.

Clause 85(2)-(3) of the LPR outlines the requirements for the keeping of records in relation to trust money subject to a specific power:

(2) If a law practice or an associate of the law practice is given a power to deal with trust money the practice must keep:

(a) a record of all dealings with the money to which the practice or associate is a party, and
(b) all supporting information in relation to the dealings,

in a manner that enables the dealings to be clearly understood.

(3) The record, supporting information, and power must be kept by the law practice as part of the practice's trust records.

A law practice must maintain a register of powers and estates in respect of which the law practice or an associate of the practice is acting or entitled to act, alone or jointly with the law practice or one or more associates of the practice, in relation to trust money. Where the power requires the law practice or associate to act jointly with another person(s) then there is no need to include this power in the register. The information to be included in the register of powers and estates is the name and address of the donor and date of each power and the name and date of death of the deceased in respect of each estate of which the law practice or associate is executor or administrator (LPR cl 86).

NOTIFICATION REQUIREMENTS REGARDING GENERAL TRUST ACCOUNTS - cl 74

A law practice establishing a general trust account after 1 October 2005 must give written notice of that fact within 14 days to the Law Society Council. Within 14 days after the closure of a general trust account, a law practice must give written notice to the Law Society Council.

A law practice is required by LPR cl 74(3) to give written notice to the Law Society Council

(a) either before, or within 14 days after, authorising or terminating the authority of an associate of the practice or an Australian legal practitioner:

(i) to sign cheques drawn on a general trust account of the practice; or

(ii) otherwise to effect, direct or give authority for the withdrawal of money from a general trust account of the practice.

(b) during July of each year, must give the Law Society Council written notice of the associates and Australian legal practitioners (including their names and addresses) who are authorised, as at 1 July of that year:

(i) to sign cheques drawn on the general trust account of the practice; or

(ii) otherwise to effect, direct or give authority for the withdrawal of money from a general trust account of the practice.

WITHDRAWALS FROM TRUST

When making payments from the trust account, a law practice must ensure that once trust money has been received it must be held for those beneficially entitled to it. The law practice must deal with that money, subject to the

provisions of the legislation, pursuant to the directions of the client. In the case of *Adams v Bank of New South Wales* [1984] 1 NSWLR 285, pp 290-92, Moffat P addressed the situation where a solicitor holds funds on behalf of a trustee:

> ... if a solicitor suspects that upon the money being paid to the client, he will apply some or all of it for purposes inconsistent with the client's duty as trustee ... no ground arises for the solicitor to refuse to perform his obligation as solicitor and pay the money as directed by his client. He might refuse to act further for his client, but he could not refuse to pay the money as directed by his client.

DEFICIENCY IN TRUST ACCOUNT

While non-compliance with a practitioner's duty to account may lead to a finding of unsatisfactory professional conduct or professional misconduct, it is possible that a criminal prosecution might be brought in addition to any disciplinary action.

Section 262 of the LPA provides:

> (1) An Australian legal practitioner is guilty of an offence if he or she, without reasonable excuse, causes:
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> (a) a deficiency in any trust account or trust ledger account; or
>
> (b) a failure to pay or deliver any trust money.
>
> (2) A reference in subsection (1) to an account includes a reference to an account of the practitioner or of the law practice of which the practitioner is an associate.
>
> (3) In this section:
>
> **cause** includes be responsible for.
>
> **deficiency** in a trust account or trust ledger includes the non-inclusion or exclusion of the whole or any part of an amount that is required to be included in the account.

WILFUL CONTRAVENTION

There may be times when a practitioner is in breach of the legal accounting requirements due to a simple mistake. If, upon discovering the mistake, the practitioner takes immediate steps to remedy the situation, it is suggested that, on those occasions, the conduct of the solicitor would not be found to be professional misconduct.

Per Mr Justice Hardie in *Re Hodgekiss* (1962) SR NSW 340, p 353 in relation to earlier legislation:

> The section deals with personal breaches of the statutory provisions in question on

> occasions when the solicitor knew or believed that he was committing such breaches, or was recklessly careless in that regard.

Mr Justice Hardie went on to say that it was essential to examine the facts and circumstances relevant to the solicitor's state of mind, knowledge, and intention at the material times. To determine whether a solicitor is guilty of professional misconduct, all of these factors will have to be taken into consideration.

A solicitor cannot delegate responsibility for the proper maintaining of the trust account. The Solicitors' Statutory Committee on the matter of Paul Vincent Wakim, reported in the supplement to the Law Society Journal August 1988, said:

> The importance of a solicitor's personal involvement in the supervision of his trust account is well illustrated by the fact that, had the solicitor in the present case been so involved and made regular inspections of the bank reconciliation statements prepared by his accountant, he would have detected at an early stage the deficiency created by the wrongful deposit. That he did not involve himself in such personal supervision amounted to the sort of reckless carelessness referred to by Hardie J in *Re Hodgekiss*.

Neither can a solicitor abandon his/her obligations to a partner or employee of the firm. In *Re Mayes and the Legal Practitioners Act* [1974] 1 NSWLR 19, Reynolds JA and Hutley JA stated, p 25:

> It is no answer for the appellant to claim that he left the conduct of the financial affairs of the firm to his partner ... The existence of a system cannot relieve partners from personal vigilance.

FIT AND PROPER PERSON

In order to remain on the roll of persons admitted as lawyers, maintained by the Supreme Court, a practitioner must comply with his/her professional duty. A vital part of that duty is to comply with accounting obligations. As Street CJ stated in *Law Society of NSW v Jones* (unreported, CA(NSW), 27 July 1978), p 10:

> Reliability and integrity in the handling of trust funds are fundamental prerequisites in determining whether an individual is a fit and proper person to be entrusted with the responsibilities belonging to a solicitor.

The courts must protect members of the public who place their trust in their solicitor. In the matter of *Law Society of New South Wales v Shenker* [1999] NSWADT 37, the Tribunal made clear that its jurisdiction was protective and not punitive. The Tribunal referred to the judgment of Sheller JA in *Law Society of New South Wales v Bannister* (1993) 4 LPDR 24 at p 28:

When the jurisdiction of the Tribunal is invoked under Pt 10, Division 7 of the Act to conduct a hearing into a complaint of professional misconduct by a legal practitioner, the primary consideration is to protect the public by preventing a person unfit to practice from holding himself or herself out to the public as a legal practitioner in who members of the public might repose confidence. The Tribunal must also act so as to deter the offender in the future and any other practitioner minded to behave in like manner.

DUTY TO REPORT IRREGULARITY

In s 263 of the LPA we find that as soon as possible after a legal practitioner associate of a law practice becomes aware that there is an irregularity in any of the practice's trust accounts or trust ledger accounts, the associate must give written notice of the irregularity to the Law Society Council and any corresponding authority.

This duty is extended to apply in the situation where an Australian legal practitioner believes on reasonable grounds that there is an irregularity in connection with the receipt, recording or disbursement of any trust money received by a law practice of which the practitioner is not a legal practitioner associate. The practitioner must, as soon as practicable after forming the belief, give written notice of it to the Law Society Council and any corresponding authority.

The section provides protection in s 263(3) to the extent that an Australian legal practitioner is not liable for any loss or damage suffered by another person as a result of the practitioner's compliance with the section.