



# TEXAS ETHICS COMMISSION



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## ETHICS ADVISORY OPINION NO. 608

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*June 18, 2024*

### ISSUE

*Whether a PFS filer who owns a law firm that holds settlement funds on behalf of a client must report the settlement funds on the filer's personal financial statement filed under Chapter 572 of the Government Code. (AOR-708)*

### SUMMARY

Settlement funds held by law firm in trust for client are not the property of the law firm and do not have to be disclosed on a PFS.

### FACTS

The requestor is a judge who owned a law firm before taking office. Before taking the bench, the requestor secured a monetary settlement for a client. The requestor remitted payment by check to the client. However, the client notified the requestor that he or she did not want the money and would not cash or deposit the check. The requestor states the law firm has ceased operations and no longer maintains any assets or has liabilities. The only remnant of the requestor's law firm is the client's settlement funds that remain in the firm's Interest on Lawyers Trust Accounts (IOLTA) account. The remaining funds are exclusively the property of a client, and no portion of the remaining funds are subject to any fees or claims for future or past service by the requestor or the requestor's firm.

A lawyer is required to keep client funds in a separate account. Tex. Disciplinary Rules of Professional Conduct Rule 1.14. An IOLTA account is a type of client trust account to hold client funds that is authorized by the state bar when "the beneficiary's funds are nominal or only expected to be held for a short period of time." *A Lawyer's Guide to Client Trust Accounts*, State Bar of Texas, January 2024 at 7 (citing Tex. State Bar R. art. XI, § 5; Rules Governing the Operation of the Texas Access to Justice Foundation, § 4). The IOLTA account bears the tax identification number of the Texas Access to Justice Foundation to whom interest earned on the account accrues.

The requestor states the firm has no lawful authority to dispose of the funds other than to safeguard them until paid to the client (or ultimately surrendered to the Comptroller as unclaimed property).

The requestor asks whether she must disclose the client funds held in trust by her former firm on her personal financial statement as either occupational income, or an asset or liability of her law firm.

## ANALYSIS

A state officer must file a Personal Financial Statement (“PFS”) that includes “an account of the financial activity” for the preceding calendar year of the filer, and the filer’s spouse and dependent children if the filer had actual control over that activity. Tex. Gov’t Code § 572.023(a). The requirements to disclose occupational income, retainers, and assets and liabilities of certain businesses owned by the filer, are all potentially implicated by this request. *Id.* § 572.023(b)(1), (9).

### **Settlement funds held in trust for a client are not required to be reported as occupational income or a retainer.**

A PFS filer must disclose all sources of occupational income and certain retainers, identified by employer, or if self-employed, by the nature of the occupation. *Id.* § 572.023(b)(1).

Occupational income is “income derived from *current* occupational activity.” Tex. Ethics Comm’n Op. No. 392 (1998). The settlement funds belong to the client and are distinct from money owed to the requestor as a fee for service. Unlike a fee earned for service, merely holding funds in a trust for a client is not occupational income and would not trigger reporting as such. Similarly, settlement funds held in trust for a client cannot be considered a retainer (i.e., a payment for future services) because the attorney has no right to the settlement funds.

### **Settlement funds held in trust for a client are not required to be reported as an asset or liability of a business.**

A PFS filer must identify by “by description and the category of the amount of all assets and liabilities” of a business entity that the filer held a 50 percent or more interest during the reporting year. Here, the settlement funds held in trust for a client are not an asset or liability of the law firm, and therefore the requestor is not required to disclose the funds on her PFS.

Settlement funds held in trust for a client by a law firm are not the property of the law firm. Rule 1.14 of the Texas Disciplinary Rules of Professional Conduct requires an attorney to “hold funds and other property belonging in whole or in part to clients or third persons” in a separate account. “The policy behind Rule 1.14 is to safeguard funds that *do not belong to the lawyer.*” *A Lawyer’s Guide to Client Trust Accounts*, State Bar of Texas, January 2024 at 3 (emphasis added).

Since client settlement funds held by a law firm do not belong to the law firm and can only be paid to the client (until surrendered to the Comptroller as unclaimed property), they are not “assets” of the firm for the purposes of Chapter 572. Therefore, a PFS filer is not required to report a client’s settlement funds as an asset of the business.

Similarly, client settlement funds in the custody of a law firm are not liabilities of the firm for purposes of Chapter 572. The term “liability” is not defined by Chapter 572 of the Government Code. However, the term is generally used to describe a legal obligation to pay a third party. Black’s Law Dictionary, Free 2<sup>nd</sup> Edition (“The state of being bound or obliged in law or justice to do, pay, or make good something; legal responsibility.”).

The firm does have an obligation to remit the settlement funds to the client (and has already attempted to do so). However, rather than a traditional business liability, the requestor is holding the client’s settlement funds as a fiduciary for the client. The funds are kept in a separate account from all operational accounts of the firm or personal accounts of the requestor. The account bears the tax identification number of a third-party nonprofit that benefits from the income earned on the account. Because the settlement funds are being held on behalf of the client by the firm, they do not need to be reported as a liability of the law firm under Chapter 572 of the Government Code.