

Internet Communications with Prospective Clients When Disclaimers May Not Be Enough

Mark L. Tuft*

We are frequently reminded that the Internet is the tool of the future. When it comes to delivering legal services over the Internet, lawyers employ various means to screen clients and avoid conflicts that could lead to disqualification. One commonly suggested means for avoiding the pesky conflict that can arise from receipt of confidential information from prospective clients is the use of disclaimers. It is thought that an effective notice or advance agreement with viewers utilizing a lawyer's web site that no client-lawyer relationship will arise and no information transmitted by the would-be client will be considered confidential will eliminate the risk of disqualification and avoid any responsibility to the person seeking employment. This paper suggests that general disclaimers may not be enough to protect the interests of the public who are invited to seek Internet-based representation and that the more traditional intake process of clearing conflicts first before inviting consumers to reveal information about their legal matter affords better protection for both lawyers and the public.

Web sites have become more than a passive means for advertising and marketing legal services. Technology affords consumers access to high speed and efficient legal services in a dynamic although often more limited way. The Internet is increasingly being used to encourage viewers to submit legal questions for on-line consideration and possible retention. An Internet-based law practice that answers legal questions and provides legal services is not prohibited so long as the protections afforded by professional conduct rules are satisfied.¹

While the Internet may be the tool of the future, finding the right lawyer continues to be a challenge for most people. Those in search of legal services will still need to consult privately with lawyers willing to consider the matter in making an informed decision whether they need a lawyer and if this is the right lawyer for their matter. Model Rule 1.18(b) mirrors case law and ethics opinions in most jurisdictions that the duty of confidentiality extends to prospective clients seeking an attorney's assistance with a view toward employing the attorney professional-

* Partner, Cooper, White & Cooper LLP in San Francisco.

1. North Carolina Formal Op. 2005-10 – A virtual law practice is permissible so long as cyber-lawyers are able to spot conflicts, deliver competent representation, maintain adequate communication, avoid UPL and generally take the same precautions as competent lawyers do in a law office setting.

ly, even if no employment results.² In most jurisdictions, pre-retention communications by those seeking legal representation in good faith with a lawyer who has agreed to consider being retained are also protected by the attorney-client privilege.³ The rationale for applying the privilege to preliminary communications is equally compelling for consumers who chose to seek legal help through the Internet. “[N]o person could ever safely consult an attorney for the first time with a view to his employment if the privilege depended on the chance of whether the attorney after hearing his statement of facts decided to accept the employment or decline it.”⁴

There is a distinction between unilateral, unsolicited communications by viewers through an email link to a web site that advertises a lawyer’s general availability and a web site that encourages on-line consultations and invites legal questions. It is generally agreed that simply maintaining an e-mail address is not enough to impose a duty of confidentiality with respect to unsolicited emails, particularly transmissions by would-be clients who are attempting to “foist” confidential information upon the unsuspecting attorney.⁵ In this context, attorneys are appropriately encouraged to use disclaimers to warn viewers against submitting unsolicited emails with confidential information where the attorney has not agreed to consider the relationship. Maintaining a passive web site that advertises a lawyer’s general availability for employment with appropriate limitations on forming an attorney-client relationship and a disclaimer that unsolicited emails requesting representation will not be considered confidential would likewise not create a legitimate expectation of confidentiality on the part of the sender.⁶ Hence, the receipt of unsolicited communications by would-be clients generally will not disqualify a law firm receiving the information from representing a client adverse to the prospective client, even if the receiving law firm could not reveal the information or use it against the prospective client, since the firm would have had no

2. MODEL RULES OF PROFESSIONAL CONDUCT, R. 1.18(b) – “Even when no client-lawyer relationship ensues, a lawyer who has had discussions with a prospective client shall not use or reveal information learned in the consultation, except as Rule 1.9 would permit with respect to information of a former client.” *And see* ABA Formal Op. 90-358; *People v. Canfield*, 12 Cal. 3d. 699 (1974); California State Bar Formal Op. 1984-84; Michigan Formal Op. RI-154(1995); Arizona Formal Op. 02-04; Los Angeles Bar Assn Formal Op. 506 (2001); REST. 3D., LAW GOVERNING LAWYERS § 15.

3. REST. 3D, *supra.*, § 70, and Comment c; MCCORMICK EVIDENCE § 88 (5th ed. 1999); California Evidence Code § 951 – “. . . ‘client’ means a person who, directly or through an authorized representative, consults a lawyer for the purpose of retaining the lawyer or securing legal service or advice from him in his professional capacity,”

4. *People v. Gionis*, 9 Cal 4th 1196, 1205 (1995).

5. Arizona Formal Op. 02-04; California State Bar Formal Op. 2003-161; *and see*, Model Rule 1.18, Comment [2] – A person who communicates information unilaterally to a lawyer, without any reasonable expectation that the lawyer is willing to discuss the possibility of forming a client-lawyer relationship, is not a “potential client” under the rule.

6. Arizona Formal Op. 02-04; *and see*, New York City Bar Formal Op. 2001-1.

real opportunity to avoid its receipt.⁷

A quite different situation arises if the web site invites the communication or otherwise creates an expectation in advance that the attorney will consider forming a professional relationship with the sender. When this occurs, potential clients have a legitimate expectation that their communications will remain confidential.⁸ Where the consumer is invited to communicate electronically with the lawyer, the lawyer has an opportunity to control the content of the information the lawyer receives in considering whether to accept the engagement. Lawyers have a duty to avoid conflicts of interests, particularly with existing clients. It is incumbent on lawyers receiving solicited on-line communications to obtain basic information up front to clear conflicts before responding to the inquiry. In offering Internet-based services in this manner, lawyers should consider apprising viewers of the need for this two step-intake process and caution that any information the viewer considers confidential should not be imparted until conflicts are cleared and the lawyer has communicated a willingness to proceed.

A two-step process in this situation offers better protection for both the prospective client and the lawyer than the use of blanket disclaimers. Lawyers are better off utilizing fill in forms, drop down menus and templates that control the information viewers are allowed to reveal until a preliminary determination is made that no conflict exists.⁹ Identifying information such as the names of the parties, their addresses, the type of case and other persons and entities involved will usually be sufficient to clear most conflicts through a reliable data base and other intake methods, such as an email alert to lawyers in the firm. If no conflict is found, the lawyer can obtain additional information during the initial period when the matter is under mutual consideration. Conflict problems can still arise during subsequent on line consultations after the initial conflicts check, as in the case of in-person consultations. However, a two-step process will reduce the likelihood of disqualification as well as attempts by savvy viewers to conflict out opposing counsel by sending emails filled with specific case information. More importantly, it will help protect potential clients who are responding to the on-line invitations for legal advice.

Disclaimers, on the other hand, are not the most effective method of avoid-

7. New York City Bar Formal Op. 2001-1.

8. California State Bar Formal Op. 2005-168; *and see* Philadelphia Formal Op. 96-2 – attorney who was a member of a referral panel for employment discrimination cases received a detailed description of a potential case on behalf of employee A. Although the attorney declined the matter and had no contact with employee A, receipt of the case description imposed a duty of confidentiality since attorney had agreed to consider employment discrimination cases referred to him. As a result, attorney could not later represent another employee in a matter in which employee A was the complaining party.

9. Rule 1.18, Comment [4] cautions that a lawyer considering whether to undertake a new matter should limit the initial interview to only such information as reasonably appears necessary for that purpose.

ing disqualification or protecting the rights of potential clients. Many people turn to the Internet for legal help without knowing beforehand where to begin. The Internet has the capability of allowing for initial disclosure of information people would not otherwise reveal if they knew the consequences. To be effective, disclaimers must use “plain language” if a potential client’s waiver of confidentiality is to be knowing.¹⁰

In California State Bar Formal Opinion 2005-168, a wife searching the Internet for a law firm that specializes in divorce, finds a law firm web site that describes the firm’s family law practice and contains a link entitled: “What are my rights?” The link leads to an electronic form that asks for the inquirer’s contact information, for a statement of facts relating to the inquirer’s legal problem and for any questions the inquirer wishes to pose to the firm. The inquirer fills out the form explaining that she is interested in seeking a divorce and provides support and employment information. She states that she is looking for an attorney who will achieve her goals in obtaining a property settlement and sole custody of the child of the marriage. She concludes with a question whether an extra-martial affair she had that she wants kept secret will have any effect on achieving her objectives.

Immediately below the text box are terms of use the inquirer is required to accept before submitting the information. The terms include an acknowledgement that “by submitting this inquiry, I understand that I am not forming an attorney-client relationship. I also understand I am not forming a confidential relationship.” Upon receiving the transmission, the law firm discovers that the inquirer’s spouse had already retained the firm to explore the possibility of obtaining a divorce.

The opinion concludes that the inquirer had a reasonable expectation of confidentiality in transmitting her information to the law firm, because the law firm invited the consultation for the purpose of considering whether to enter into an attorney-client relationship with the inquirer. The law firm did not use sufficient “plain language” in its disclaimer to defeat her reasonable belief that she was consulting the firm for the purpose of possible employment. As a result, the firm could not avoid assuming a duty of confidentiality with respect to the information received by requiring the inquirer’s acceptance of the terms of use. Therefore, the firm would be disqualified from representing either party in the divorce.

The opinion suggests that had the law firm used clearer language in its agreement with the inquirer to the effect that “I understand and agree that the law firm will have no duty to keep confidential the information I am now transmitting to the firm,” the law firm could have “defeated” the inquirer’s reasonable expectation of confidentiality and avoided a duty to not reveal or use any of the information the firm had solicited. However, one wonders whether this is a preferred solution. It is

10. See, e.g., California State Bar Formal Op. 2005-168; Virginia Formal Op. 1794 (2004).

one thing to have a disclaimer that warns consumers not to send unsolicited confidential information and another that requires potential clients to enter into a “click wrap” agreement that has the effect of waiving confidentiality as to information the lawyer has encouraged the consumer to send. Use of such disclaimers in this situation would not promote the strong public policy of encouraging clients to seek legal advice, nor would it seem to promote the Internet as an alternative for traditional in-office consultations. Even if the disclaimer was crafted in sufficient plain language to be effective, it is not clear that the law firm would be able to reveal or use the wife’s information in representing the husband.¹¹

A better way to proceed that would avoid the confidentiality issue would be to require the inquirer to submit limited information that would allow the law firm to perform a conflicts check. In the situation addressed in California State Bar Formal Opinion 2005-168, the firm would first want to ensure that it does not represent the other spouse. The dialog box or drop down form could be limited to identifying the names of the parties, addresses, children, former spouses, relevant maiden names, and the subject area. Most consumers will understand and appreciate an explanation on the web site that the reason for requiring limited information as the first step in considering the potential client’s matter is to protect the interests of the law firm’s existing clients.¹²

Additional problems can arise when the lawyer seeking on-line information from prospective clients ends up accepting the engagement. Employing disclaimers that require prospective clients to agree that no confidentiality exists with respect to information the client is invited to submit at the outset may have the effect of vitiating the client’s claim of privilege and exposing the information to later discovery that could prejudice the client’s case.

In *Barton v. U.S. District Court*,¹³ a drug company’s discovery request for opposing counsel’s Internet questionnaires soliciting extensive information from potential class members concerning the company’s antidepressant drug was denied on the grounds that the disclaimer at the end of the questionnaire was too ambiguous to constitute a waiver of the attorney-client privilege.¹⁴ The “yes box” disclaimer which each person responding to the questionnaire was required to

11. Compare, New York City Formal Op. 2001-1, which concludes that a prominent and clear web site disclaimer stating that nothing will be treated as confidential until the prospective client has spoken with an attorney who has completed a conflicts check would be sufficient to vitiate any attorney-client privilege claim with respect to unsolicited information transmitted by would-be clients in the face of such a warning.

12. It is recognized that on occasion the fact that an inquirer is seeking advice or representation with respect to a particular matter, such as a divorce, can itself be confidential.

13. 410 F.3d 1104 (9th Cir. 2005).

14. In *Barton*, the court did not certify the class and the law firm ended up going to trial initially with five plaintiffs, four of whom had returned questionnaires relating to their experience with the antidepressant drug. The drug company sought the questionnaires in discovery as a means of impeaching the clients’ deposition testimony.

check before sending the email included the statement: “I agree that the above does not constitute a request for legal advice and that I am not forming an attorney client relationship by submitting this information.” In denying the drug company’s discovery request, the court found that the law firm’s ambiguity in failing to include an express waiver of confidentiality should not result in the loss of the clients’ privilege.

No doubt lawyers can come up with better disclaimer language than that used in *Barton* and in California State Bar Formal Opinion 2005-168. However, it remains to be seen whether Internet sites that encourage the transmission of confidential information can effectively avoid any responsibility to potential clients through the use of disclaimers. Comment [5] to Rule 1.18 provides that a lawyer may condition conversations with a prospective client on the person’s informed consent that any information disclosed during the consultation will not prohibit the lawyer from representing a different client in the matter. The agreement may also expressly provide that the prospective client consents to the lawyer’s subsequent use of the information. However, “informed consent” under Rule 1.0(e) denotes agreement after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.

A lawyer receiving “disqualifying information” from a prospective client (defined in rule 1.18(c) as information that “could be significantly harmful to that person in the matter”) may nevertheless represent a client with interests materially adverse to those of the prospective client in the same or a substantially related matter if (1) both the affected client and the prospective client have given informed consent, confirmed in writing, or (2) “the lawyer who receives the information took reasonable measures to avoid exposure to more disqualifying information than was reasonably necessary to determine whether to represent the client;” and the lawyer was timely screened from any participation in the matter (and receives no fee there from) and the prospective client is given prompt written notice.¹⁵ Lawyers who solicit email communications from prospective clients containing “disqualifying information” with a notice that the information will not be treated as confidential, without first clearing conflicts, may find it difficult to satisfy the requirements of rule 1.18(d)(2).

Requiring potential clients seeking Internet-based legal services to waive confidentiality with respect to their initial communications as a means of avoiding disqualification may not always serve the public interest. The objective should be to adapt technology in a way that maintains the same degree of professionalism and protection of the interests of prospective clients as in the more traditional law office setting.

15. MODEL RULES OF PROFESSIONAL CONDUCT, R. 1.18(d); *and see* Rule 1.0(k) for requirements for screening procedures.

The Check (*Cheque*) is not *Always* in the Mail: Ontario By-Laws on Electronic Transactions and Record Keeping and Related Concerns about Cheque Imaging

Daniel J. Abrahams*

I. INTRODUCTION

Technology in the land of commerce is evolving as rapidly as in any other field of human endeavour. To remain effective, regulators must be alert and responsive to change, even when it happens outside their immediate sphere of influence. This is certainly true for those of us who regulate lawyers and who attempt to ensure that the public remains protected from dishonest members of the legal profession.

Unfortunately, the sheer pace of technological change, notably including change in the financial services industry, makes it relatively easy to overlook the significance of some developments. The cost of less-than-total vigilance might be diminished regulatory effectiveness. This in turn could result in lawyer dishonesty left undetected, or un-prosecutable, and hence unpunished. From the standpoint of client protection and client compensation funds, we also risk unexpected drains on inevitably finite and precious financial resources.

(a) The Law Society of Upper Canada

The Law Society of Upper Canada was founded by statute in 1797. Its role is to govern the approximately 34,000 lawyers practising in what is now the Province of Ontario, Canada. The Society's central mandate is to regulate the legal profession in the public interest. This includes ensuring the competence, capacity and ethical conduct of all of the Society's members.

The Law Society determines who can become a lawyer and who can remain a lawyer. It sets the standards for admission and it makes the rules of professional conduct. It investigates complaints and prosecutes those who warrant formal discipline. It also makes rules that determine how lawyers in private practice must deal with client funds, and how they are required to account to their governing body for the operation of their trust accounts. If a lawyer steals money from a client, it is the Law Society's Fund for Client Compensation to which the client

* Counsel, Office of the Director, Professional Regulation, at The Law Society of Upper Canada, Toronto, Ontario, Canada. While the author acknowledges the invaluable assistance of colleagues and resources at the Law Society of Upper Canada and the Federation of Law Societies of Canada, the views expressed here are his alone and do not necessarily reflect the position of either organization.

may well turn for redress. If a lawyer is found to be negligent, a Law Society-owned mandatory insurance company, the Lawyers' Professional Indemnity Corporation, aka LawPRO, may pay the judgement or settlement.

In short, whereas the regulation of lawyers and protection of clients in American jurisdictions may be spread among a number of Bar, state and judicial entities, in Ontario (and other Canadian provinces and territories), it is the Law Society – the governing body of a self-regulating legal profession – which holds most, if not all, of the regulatory cards. The Society's responsibilities are broad, indeed.

(b) The Law Society's response to technology

As part of its regulatory responsibilities, the Law Society attempts to keep abreast of technological change in areas where lawyers operate. A few years ago, in 2002, the Law Society turned its attention to the growing impact of electronic transactions on everyday commerce. It asked the questions, "What will all of this mean for lawyers? What will mean for us as a regulator?" The initial answer is the subject of this paper. But, as the paper also points out, there are many more important questions still to be addressed, in some cases rather forcefully. This is especially true as the era of paper cheque transactions rapidly gives way to an increased reliance on electronic imaging, a development driven to a great extent by powerful financial institutions.

II. THE BYLAW ON HANDLING MONEY AND OTHER PROPERTY: BYLAW 19

(a) Section 2

Under its statute¹, the Law Society enacts both Rules of Professional Conduct and Bylaws to govern various aspects of lawyer conduct. Bylaw 19 deals with the handling of "money and other property". At least with respect to the former, its key provision is section 2. This section of the by-law obliges every member (that is, every lawyer in Ontario) who receives money in trust for a client to pay that money into a designated trust account. The account must be held in the name of the member or his or her firm, at a bank or other specified type of financial institution.

(b) Section 3

In addition, section 3 specifies which money may be withdrawn from a trust account:

- money required for payment to a client or a person on behalf of a client;
- money to reimburse the member for disbursements;
- money for fees for which a billing has been delivered;
- money to be transferred into another client trust account;
- money put into the trust account by mistake; and
- money withdrawn with the permission of the Law Society.

While it may be intuitive to most people, the bylaw also prohibits lawyers

1. *Law Society Act*, R.S.O. 1990, c.L-5, as am. The Law Society by-laws discussed in this paper, together with the legislation under which they were made, can be readily accessed on the Society's website: www.lsuc.on.ca.

from taking out more in respect of a client than is actually held in trust on that client's behalf.

Bylaw 18 imposes further obligations with respect to how records of such deposit and withdrawal transactions must be kept; we will talk more about that later. But for the moment, let us keep our focus on Bylaw 19.

(c) Controls on withdrawals from trust accounts

It is axiomatic that trust account money does not belong to the lawyer. It must be protected from the risk of both theft and inadvertent loss. Hence a prudent regulator, such as the Law Society of Upper Canada, does not just stipulate when the money must be put into trust and when it may be removed from trust. It also dictates the *manner* in which these things should occur.

Traditionally, money could be removed from a trust account in one of two ways: by a cheque drawn in the member's favour (and not made payable to either "cash" or "bearer"), or by a bank transfer to the member's (general) bank account.

Mindful of the introduction of ATMs, on-line banking and other innovations, the 2002 amendments added a third mechanism: by electronic transfer, in accordance with section 7 of the by-law. This section does not offer lawyers *carte blanche* to transfer electronically that which would otherwise be removed by paper cheque or transfer by bank teller. Rather, it insists on a human element, proper documentation and appropriate oversight. All of this helps ensure that both errors and outright theft are actively discouraged.

(d) Section 7

Section 7 is quite comprehensive and relatively straightforward. It states that the electronic transfer system **MUST** be one that requires one person to enter the data describing the details of the transfer, and another person to actually give effect to the transfer. Each of the two must use a password or access code. The electronic transfer system must also generate, by the end of the next banking day, confirmation of receipt of the data describing the transfer and authorizing the financial institution to process it. This confirmation must specify the originating trust account number, the name of the person or entity to whom the destination account belongs and the number of that account. It must also confirm the time and date of both the request for transfer and the confirmation sent to the lawyer.

The section also imposes a variety of obligations on the lawyer who is utilizing the electronic transfer system. In most cases, the lawyer must personally sign an electronic trust transfer requisition before the transfer can take place. Moreover, the section specifies that by the end of the next banking day following the transfer, the member (typically; departures from this are available only in what the by-law describes as "exceptional circumstances") is obliged to:

- generate a printed copy of the confirmation
- compare it to the original requisition and ensure that the two are consistent
- add identifying information about the client, the subject matter and the file number; and
- sign and date the confirmation.

Some may consider this an extraordinary level of oversight. Yet it is clearly intended to minimize the prospect that an electronic transfer system will be used to pillage a client trust account. Moreover, it restricts a lawyer's ability to assert, when such a loss becomes apparent to an investigator, that it was the "system" that permitted it to happen.

(e) Closing funds

It is worth noting that the by-law also deals separately with electronic transfers of closing funds. Closing funds are defined, in section 7.1, as money necessary to complete or close a real estate transaction. Closing fund transfers by electronic means are subject to restrictions and oversight provisions. These include the need for passwords or access codes, the obligation to generate both a requisition and confirmation and verify that the two are the same, etc. In short, the provisions for electronic closing fund transfers essentially mirror those for other types of electronic transfers.

(f) Automatic withdrawals

Finally, in sections 8.1 thru 8.4, By-Law 19 addresses the automatic withdrawals that are permitted to occur in the context of an electronic real estate transaction using Ontario's so-called Teranet system. Such withdrawals are for document registration fees and the land transfer tax. Apart from imposing a modified regime, similar to that found in sections 7 and 7.1 for authorization and confirmation of such withdrawals, the Teranet provisions also mandate the establishment of special trust accounts. These accounts are to be used exclusively to facilitate electronic registration fee and land transfer tax withdrawals. Special trust accounts are tightly controlled, even more so than regular trust accounts. For instance, the by-law stipulates that money shall be held in a special trust account for no more than five days, after which, failing a Teranet withdrawal, the money must be transferred back to an ordinary client trust account.

III. THE BY-LAW ON RECORD KEEPING: BY-LAW 18

Like other regulators, the Law Society of Upper Canada imposes certain minimum standards on record keeping, especially by lawyers in private practice. As with By-Law 19, the dominant objective is to protect client monies held in trust. The Law Society's requirements ensure that lawyers are accountable both to the client and to the regulator for the proper operation and safeguarding of client trust accounts. Review of a lawyer's mandatory financial records will also help the Society to determine whether serious misconduct, such as misappropriation of client trust funds, has actually occurred.

Most of the record-keeping obligations are found in By-Law 18. Again like By-Law 19, By-Law 18 envisions an increasingly electronic environment. It, too, accommodates an increased reliance on electronic recordkeeping.

The by-law does not itself, however, ensure the accuracy or reliability of an electronic record (such as an imaged cheque) in a lawyer's possession. As dis-

cussed in more detail in the next section of this paper, this point has particular significance as Canada and other jurisdictions move closer to a predominantly imaged environment for cheque processing.

(a) Section 2

By-Law 18 canvasses a number of forms of records and transactions. For our purposes, it is most important to focus on section 2. This section requires every member of the Law Society to “record all money and other property received and disbursed in accordance with the member’s practice”. It specifies twelve types of records that lawyers must keep. These include various types of books of original entry, client trust ledgers, fees books, reconciliation statements, bank passbooks, etc. Not surprisingly, the list also includes the signed electronic transfer requisitions and confirmations of transfers of trust funds as well as the signed Teranet withdrawal authorizations and confirmation described above.

Also notable among the list of records in section 2 is the requirement in paragraph 10: “bank statements or pass books, cashed cheques and detailed duplicate deposit slips”. Before the advent of cheque imaging, this would mean that members would receive and store cancelled cheques, among other things, to comply with the by-law. This in turn would enable an investigator or auditor to verify the legitimacy of trust transactions (noting that the issuance of cheques is one of the three methods by which trust monies can be expended pursuant to By-Law 19).

(b) Electronic storage

In the digital era, however, hard copies are no longer guaranteed. This is why section 4 By-Law 18 provides, first, that all financial records described in section 2 may be stored electronically but, also, that “if a financial record is posted by ... electronic means, a member shall ensure that a paper copy of the record may be produced promptly on the Society’s request.” A financial record posted by electronic means would, therefore, include an imaged cheque, and producing it promptly would mean that the lawyer would have to be able to generate a reliable hard copy.

(c) Duration of obligation

These are not short-term obligations. According to section 6 of the by-law, most records must be capable of production by the member for six full fiscal years. Cancelled cheques, however, fall within a category of records that must be kept for a minimum of ten fiscal years.

In short, a member’s keeping of electronic records – again, most typically cancelled cheques that have been imaged – will comply with By-Law 18 if the lawyer keeps or is able to produce *reliable* copies of imaged records for a minimum of ten years.

As is often said, though, in these situations, the devil is in the details...

IV. KEEPING TRACK OF IMAGED CHEQUES: SOME QUESTIONS FOR REGULATORS TO ASK

Like those in other jurisdictions, notably the United States, Canada’s major

financial institutions are moving rapidly to replace the complex process of clearing paper cheques with a more streamlined, and ostensibly more cost effective, electronic system. This raises some interesting questions, especially in the context of the 10 year record keeping obligations imposed by By-Law 18.

(a) Advantages of imaging

The trumpeted advantages of electronic imaging, clearing and retention are well known. They include, among others, more convenient access to account information, improved speed and efficiency in processing, easier record keeping, and an enhanced ability to do account reconciliation. But as we said at the outset, this new technology also demands the attention of the regulator, to ensure that the regulatory mandate and function remain unimpeded.

(b) Imaging in Canada

In very basic terms², within the next couple of years, it is expected that most hard copy cheques in Canada will be imaged. Images will be captured either upon deposit or shortly afterwards, when the cheque is delivered to the financial institution's regional processing centre. It is the imaged cheque which will be cleared and which will ultimately be "returned" (electronically or by hard-copy printout accompanying a monthly statement) to the customer upon whose account the cheque is drawn. It is the imaged cheque which will stimulate the removal of funds from one account and the deposit of those funds into another account. It is also the imaged cheque which will become the official record of the transaction. The hard copy cheque will be retained at the point of image capture (either the branch or the regional centre), but for only for a limited period – perhaps as short as 10 days. After that, it will be destroyed.

(c) Concerns related to By-Law 18

As we have seen, By-Law 18 requires lawyers to produce cancelled cheques on demand for a minimum of ten fiscal years. The rationale for this is to establish a paper trail from the lawyer's client trust account to the payee, and back to the lawyer who has kept the cheque *in specie*. The Law Society has also recognized that cancelled cheques, for the purpose of By-Law 18, *can* include imaged cheques that can be printed and produced in hard copy.

But acknowledging that imaged cheques are acceptable in principle is not the same as offering a blanket endorsement of all imaging protocols and practices. It is not beyond the pale to worry about what an unscrupulous actor might try to do to an imaged cheque, perhaps with the aid of some fairly basic, and now ubiquitous, digital image manipulation tools. One example of possible manipulation of

² Source: Canadian Payments Association, "The Transition to Cheque Imaging: Record Retention for Cheques and Other Payment Items", Consultation Document, November, 2001. Various organizations, including the Federation of Law Societies of Canada, have responded to this Consultation Document. The Canadian Payments Association is currently reviewing the submissions it received.

the system could be where a dishonest lawyer alters the digitalized cheque drawn on a trust account for a legitimate purpose, to show a higher amount than was actually the case, and thereby shield a payment made for an illegitimate purpose.

In the course of audit or investigation, regulators need to be able to rely on an imaged cheque as authentic. Hence the regulator needs to ask a lot of questions when a new imaging and retention protocol is introduced. These questions will explore issues of security, accountability and cost, among others.

(d) Security considerations

It is likely that many of the questions we are asking in Canada will also resonate elsewhere. Here, then, are some questions that Canadian regulators, might ask when probing the security and reliability of a cheque imaging protocol:

When the financial institution returns copies of imaged cheques, or when the lawyer prints them off the on-line Internet banking site, in his or her office, how can one verify that the front and back (the latter containing the endorsement) belong to the same cheques? Is this the responsibility of the drawee institution? How does the drawee institution verify that good images have been captured?

For what period must the financial institution retain the imaged cheques? Is this left to the individual institution to determine, or are there national standards? At least in Ontario, our obligation to regulate the legal profession and to investigate alleged misconduct is not subject to statutory or other time limits. Is it worth suggesting, then, that imaged cheques drawn on client trust accounts should be stored by a reliable entity in perpetuity?

What is the appropriate schedule for retaining the original signed copy of an imaged cheque before it is destroyed? Say a lawyer is required to resolve trust account discrepancies within 30 days. The imaged cheque may not come back to the lawyer until almost that period has elapsed. In these circumstances, even 30 days for retention of a paper cheque, for comparison and verification purposes, may not be long enough, and 10 days is certainly insufficient. Would, say, 45 days be long enough?

What specific indicators of authenticity will replace fingerprints, watermarks and, of course, actual signatures, as probative tools, once the original cheque is destroyed?

What standards and procedures exist to confirm that the signatures on imaged cheques are reliable, especially once the source cheques are destroyed? To what extent can a handwriting expert assess such signatures, if they are challenged?

Whose responsibility is it to ensure that the bank copy, stored electronically, is the same as the payor's copy of the imaged cheque?

(e) Standards and accountability

Regulators might also seek assurances that there will be a clear source of accountability, and universally recognized standards and controls for cheque

imaging. Ideally, there would be an ongoing, permanent and independent review (quality control) process, capable of certifying (and where appropriate, testifying) that an imaged cheque is akin to a “true copy”.

It is also worth considering whether compensation might be available from financial institutions if security or quality control systems fail and loss due to lawyer dishonesty is incurred as a result. Can, for example, Client Protection funds seek restitution for loss that is wholly or partly facilitated by cheque imaging vulnerabilities? (Perhaps, though, the *better* question is whether a client or other party who has been wronged by a lawyer who was able to forge or alter an imaged cheque drawn on a trust account can seek redress from the bank directly!)

(f) Evidentiary considerations

At the prosecution stage, it is trite law in Canada that any evidence presented in a courtroom or before an administrative tribunal (such as a Law Society discipline hearing panel) must be the “best evidence” available. It is legitimate to inquire if statutory amendments are required to guarantee that “cheque”, for evidentiary purposes, will in all circumstances include a digital image of a cheque. Will existing rules suffice in your jurisdiction? Or will you face difficulties establishing that an imaged cheque purportedly drawn (improperly or otherwise) on a lawyer’s trust account is *bona fide*?

(g) Technical and cost issues

If, as is the case in Ontario, a jurisdiction expects its lawyers to be able to produce imaged cheques on demand for a specified period, this gives rise to a whole set of technical and cost questions. For example:

Will special software and/or hardware have to be purchased to ensure that lawyers and notaries can securely store and print imaged cheques, both during the period when they are stored in the database of the financial institution and afterwards?

Will the regulator even have access to imaged documents in the possession of the financial institution for storage purposes, when the lawyer who is under audit or investigation has generated or otherwise handled those documents? What retrieval costs will be involved?

What, if any, costs will be charged for viewing imaged cheques on-line? What would a customer have to do to retrieve and compare a paper cheque during the retention period, before the paper cheque is destroyed?

Will there be a single format for the return of digital images in hard copy (that is, when the images are not printed locally by the customer)? Will such a standard format include the front and back of each cheque? Will there be legibility requirements – for instance, no more than eight, high-resolution images per page?

(h) Anticipated response from financial institutions

Some of these concerns are more likely to be satisfied than others. Banks and other financial institutions may be willing to improve security to some extent, to pro-

mote overall consumer confidence in the new technology. They may, however, be less willing to respond to the more specific concerns of those who regulate lawyers.

Retention schedules are one likely point of contention. Obviously, banks will be reluctant to store bulky original cheques for anything longer than a token period. They take up valuable, and expensive, storage space. Financial institutions may also balk at the notion of extended storage of cheque images that, given transaction volumes, will over a relatively short period of time consume many, many terabytes of computer memory.

Regulators can also expect financial institutions to assert that electronic imaging, when properly implemented, is less amenable to fraud than conventional paper clearing methods. Arguably, an imaged cheque is hard to alter or forge than a paper one. This may or may not be 100% valid, but regulators are certainly entitled to ask financial institutions to back up such assertions with hard data and proof that adequate safeguards are in place.

Ultimately, it is the regulator's obligation to ensure that the right questions are asked, and asked again, especially when the initial answers are not entirely satisfactory.

V. CONCLUSION

The Law Society of Upper Canada, like other regulators, has demonstrated its awareness of the need to keep pace with technology. Changes to its by-laws on money handling and record keeping reflect that appreciation. The changes, particularly the provisions dealing with electronic funds transfers in By-Law 19, balance traditional concerns about accountability and oversight with a willingness to accommodate new technologies *so long as appropriate safeguards are maintained*.

Much, however, occurs outside the scope of the regulator's influence. This is especially true where large financial institutions are concerned. The movement towards an image-based cheque-processing environment is one obvious illustration of a situation where the regulator must assert itself. The role of the regulator is to ensure that changes made for the sake of technological efficiency and cost effectiveness nonetheless preserve its ability to protect the public from dishonest lawyers.

Of course, it is fair to say that, in most jurisdictions, governments are the final arbiters of competing public policies. They are perhaps best situated to ensure that even the most worthwhile, customer-friendly (and e-commerce friendly) evolution of technology in the financial services industry does not undermine the functions assigned to professional regulators. These include the prevention, investigation, prosecution and compensation of lawyer misconduct.