PROFESSIONAL COUNSEL®

Advice and Insight into the Practice of Law®

Escrow Entanglements: Avoiding Assumptions and Malpractice Exposures

Introduction

Funds held in escrow often represent more than just money – they embody the hopes and dreams of the client. Whether it's the dream of purchasing a new home, seizing an investment opportunity, or starting a family, these funds are tied to significant life goals and expectations. In other cases, escrow accounts may be linked to the dissolution of marriages or businesses, carrying emotional weight of a different kind. For attorneys managing these funds, it is crucial that all parties – the attorney, the client, and any third parties – clearly understand the intended use of the funds. While many escrow arrangements begin with optimism and mutual agreement, it is essential to remain prepared for the complexities and challenges that may arise.

Cautionary Tale

A cautionary tale of escrow gone wrong involves allegations that over ten million dollars vanished from multiple escrow accounts held by a surrogacy escrow company in Texas.[1] Impacted families in the U.S. and Europe believe that their funds deposited into escrow accounts were used to fund the lavish lifestyle of the owner of the escrow company, rather than the intended purpose of covering medical bills related to surrogacy.[2] It has been alleged that the stolen funds were transferred out of the escrow accounts and were used to fund a fashion line and the music career of Surrogacy Escrow Account Management ("SEAM") owner Dominique Side.[3] At the time of this writing, dozens of families have sued Side in Texas and the FBI is investigating.

This cautionary tale offers many lessons to be learned for attorneys and law firms. First, it is a reminder that attorneys and law firms must conduct their own due diligence for the individuals and entities that assist them in their attorney-client relationships.[4] It is hazardous to assume that those providing outside services are aware of the expectations for services. Attorneys must provide guidance on protocols and the expectations for all involved in the attorney-client representation. In addition, those providing services to the client should be supervised for proper performance. Attorneys should be aware of their obligations under American Bar Association ("ABA") Model Rule of Professional Conduct 5.3: Responsibilities Regarding Nonlawyer Assistance, "With respect to a nonlawyer employed or retained by or associated with a lawyer." The duty to supervise is beyond the confines of a law office.

Attorneys and law firms must vet their vendors. They must know who they are working with, their history of working with law firms, expectations of confidentiality, data privacy concerns, error disclosure and potential contact with clients. Failure to investigate may lead to errors and oversight creating an exposure for legal malpractice or disciplinary actions.

1 Coburn et al. July 31, 2024. From hope to heartbreak: Families allege surrogacy escrow company stole millions, *ABC News*.
2 Flores et al. July 19, 2024. Nearly 2 dozen families claim owner of Houston surrogacy escrow company stole millions to fund lavish lifestyle, *CNN US*.
3 Ozebek. July 31, 2024. From hope to heartbreak: 13 Investigates tries to confront woman at center of alleged surrogacy scam, *ABC 14 News*.

4 See CNA's Professional Counsel, Law Firms and Outsourcing: Trust but Verify

Law firms should avoid creating a stream of business for an outside individual or entity. When there is a need for experts, vendors or an escrow agent/agency, the client should be offered multiple options to select who will be involved in the representation and how much they will pay for those services. Allegations of negligent referral may be avoided by allowing the client to be involved by conducting their own research and making the final decision on which vendors will assist over the course of the representation. As attorneys will likely have their own battles with clients over invoices and fees, there is no need to bring in an additional flashpoint related to outside entities and fees for their services.

Another lesson to be learned from the Texas debacle is the importance of an escrow agreement that assigns responsibilities for managing escrow funds, access to funds, audits, security, dispute resolution and communication related to fund management. The escrow agreement establishes the requirements and path to be followed; clients must be aware of its existence and purpose.

Attorneys should be aware of how an escrow agreement is established in their jurisdiction(s) of practice. For example, in New York, an escrow agreement is established if it is shown "that there is (a) an agreement regarding the subject matter and delivery of the funds, (b) a third-party depositary, (c) delivery of the funds to a third party conditioned upon the performance of some act or the occurrence of some event, and (d) relinquishment by the grantor or depositor."[5] Too often, attorneys will identify funds as being held in escrow when these steps have not been established. Attorneys are responsible for properly identifying which funds are appropriate for escrow related to the client representation and underlying transaction.

Client Education on Options in Escrow

With escrow matters, attorneys should consider their client's level of sophistication and experience with the specific type of transaction or representation. While many clients may be familiar with escrow accounts related to the purchase of a home or funds held in escrow related to their mortgage payments to cover property insurance or taxes, they must nonetheless be made aware of the funds that are being held in escrow and each specific intended use.

The next step is to educate the client on their options as to who will hold the funds. Many clients may assume or prefer that their attorney hold escrow funds, but each matter should be evaluated for the best option related to the transaction. Clients should have a clear understanding why funds are being held in escrow and how and when those funds will be distributed. Many clients will assume that if their attorney holds the escrow funds, they control how the funds will be managed. Clients must be made aware of the escrow holder's fiduciary role to all involved in the related matter. The divided loyalty between a client and an intended recipient of escrow funds may create a legal malpractice or disciplinary exposure when funds are disputed.

For clients who are unfamiliar with transactions requiring escrow, attorneys should take the time to inform them of the basics – the purpose of escrow, the role and responsibilities of an escrow agent and the escrow agreement that will dictate how the funds will be managed and distributed.

Attorney Acting as Escrow Agent

Oftentimes, clients will assume or prefer that their attorney act as the escrow agent. If the attorney will act as an escrow agent, before finalizing the terms of the agreement, attorneys should work with their clients and make sure they understand the planned route for the funds and how that plan may be disrupted, canceled or veer completely off course. Clients are likely focusing on the positives of the transaction, but their attorneys should advocate for them by discussing the various ways the plan may change. One of the first complaints from a client related to the escrow account will likely be, "Why didn't you tell me we could lose the money?" or "Why didn't you warn me that things could go so wrong?" These questions reinforce the importance of discussion and education at the beginning of the attorney-client relationship.

5 *Mortg. Elec. Registration Sys., Inc. v. Maniscalco*, 46 A.D.3d 1279, 1281, 848 N.Y.S.2d 766 (N.Y. App. Div. 2007) (internal quotation marks, citations, and brackets omitted); *accord Mid-Island Hosp., Inc. v. Empire Blue Cross and Blue Shield. (In re Mid-Island Hosp., Inc.)*, 276 F.3d 123, 130 (2d Cir. 2002).

Attorneys acting as an escrow agent must recognize the difference between legal fees under American Bar Association ("ABA") Model Rule 1.5: Fees and Rule 1.15: Safekeeping of Property.[6] Should a dispute arise related to funds held in escrow, the attorney acting as escrow agent must be able to show all necessary records and that the funds were deposited into the appropriate account, typically an IOLTA account.

For those attorneys acting as an escrow agent, ABA Model Rule of Professional Conduct 1.15 or their state equivalent should be reviewed. In addition, any state-specific ethics opinions related to an attorney acting as an escrow agent or funds in dispute should be reviewed, as well. Attorneys should also confirm if any federal or state statutes exist that govern the handling of funds held in escrow. The attorney holding escrow should not assume that it is a simple process that is the same or similar to managing legal fees.

Acting as an escrow agent creates a fiduciary role with the attorney's clients and third parties involved in the transaction. Clients must understand that they do not have the upper hand or more power related to how the funds will be managed because their attorney is the escrow agent. The escrow agreement will dictate how and when funds will be transferred. Again, by explaining the differences between acting as their attorney and an escrow agent may help to avoid creating a disgruntled client that cannot grasp why they cannot have their money back or receive anticipate funds. In addition, the discussion with the client may make it obvious that it would be best for another individual or entity to act as the escrow agent rather than their attorney. Attorneys acting as an escrow agent should also be aware that acting in this role may create an additional exposure should the third party allege breach of fiduciary duty by the escrow agent, aiding and abetting a breach of the fiduciary duty of the escrow agent and negligence by the escrow agent.[7] Attorneys may face disgorgement of legal fees if they were improperly paid from escrow funds.

Escrow Department

For some transactions that involve large amounts of money, such as real estate or mergers and acquisitions, the entities that conduct the transaction such as the bank, real estate broker or mortgage company may have their own escrow department to manage the funds. Again, the client should be educated on who is holding the funds, the escrow agreement that dictates how they will be handled, how the funds are protected, and what would happen should a dispute arise.

Third Party Escrow Company

Escrow companies are another option that may be available for a client. The obvious benefit of using a third party escrow company is that it is literally their business. They are focused on proper documentation, management, security and dispute resolution, should a dispute arise. The escrow company's experience in dealing with funds in dispute is beneficial to the attorneys involved because they are not in a position of divided loyalty between their client(s) and others involved in the transaction or representation. The ultimate decision of what will happen to the funds held in escrow will be made by the escrow company or, possibly, a court.

The escrow company will also be responsible for managing, distributing and protecting the escrow funds. As seen in the Texas matter, law firms must know who they are working with and offer multiple options for the client to choose from in selecting an escrow company.

Wire Fraud Warning

No matter where funds in escrow are being held, clients must be warned against wire fraud.[8] Law firms should advise clients on their protocols related to wire fraud even if it is simply, "We do not transfer funds via wire and will never ask your for information related to such." Wire fraud has expanded outside real estate as the most vulnerable area of practice. Educating clients is the first step in avoiding being a victim of wire fraud.

Funds in Dispute

In an ideal world, funds held in escrow are held for the necessary time period and then transferred to the appropriate party when escrow agreement terms are met or a settlement is reached. In reality, funds held in escrow are likely to be disputed by clients, opposing parties, attorneys or third parties. Due to the likelihood a dispute will arise related to funds held in escrow, attorneys should warn clients at the very beginning of the representation. Clients should also be reminded that if their attorney is holding the funds in escrow, that does not mean the client has the final say on how the funds will be handled. The attorney holding the funds has established a fiduciary relationship with the payor of the escrow funds and the planned recipient of the funds. Loyalty to both parties is required as the escrow agent/holder.

6 See CNA's Professional Counsel, Client Trust and IOLTA Accounts: Managing Money and Avoiding Risk
7 *In re Kapsar*, 667 B.R. 195 (2025)
8 See CNA's Professional Counsel, Top 10 Risk Control Tips to Avoid Wire Fraud Scams

Model Rule of Professional Conduct 1.15(e) addresses situations where a lawyer holds property – often funds – in which two or more parties claim an interest. The rule requires the lawyer to keep the disputed property separate until the conflict is resolved. Importantly, the lawyer must promptly distribute any portion of the property that is not in dispute. In practice, this means attorneys must maintain clear records, avoid disbursing contested funds at the direction or demand of a client or third party and communicate transparently with all parties involved. Lawyers need to establish a reliable system for identifying and tracking disputed versus undisputed funds, and to act swiftly in distributing the latter to avoid unnecessary delays or ethical complications. Additionally, the lawyer needs to avoid acting as the arbitrator and not attempt to resolve the dispute themselves. If the parties cannot come to an agreement, the lawyer may consider filing an interpleader action to have a court determine the rightful owner of the funds.

Resolution

Should funds in escrow remain in dispute, the attorneys connected to the transaction or representation should attempt to offer paths to resolution. When the parties are made aware that while the funds are in dispute neither party will receive them, they may be more motivated to work out a distribution agreement. Assuming that is not possible, mediation, arbitration or litigation may be the next best option. If the journey to resolution is long or impossible, the parties connected to the escrow should be made aware of where the money will be held pending resolution. The funds may stay with the escrow agent or, depending on the jurisdiction, may need to be turned over to the a court for safekeeping. The funds should not be transferred until all parties have been notified to avoid any allegation of misuse or theft.

Escrow Checklist

Is it best for the funds to be placed in an escrow account?

- Are the funds nominal or substantial?
- What is the amount of net interest that trust funds are capable of earning for a client/third person?

How long will the funds be held?

- Is there an escrow agreement in place?

Are clients aware of why funds are being placed in escrow and the intended use?

Are clients aware of their options related to escrow?

Where should the funds be held?

- Law firm of client?
- Law firm of opposing counsel?
- Financial institution?
- Third party escrow company?

Have external individuals or entities been investigated and verified for appropriate services and experience?

If applicable, did client select the escrow company to hold funds?

Who will have access to the funds?

- Transfer authority?
- View-only access?

Have the clients been educated on the purpose of escrow, their options, escrow agent and escrow agreement?

What steps are being taken to protect the client funds?

- Warning on wire fraud?
- Law firm protocol for wire transfers?

Are clients aware of what will happen should a dispute arise over the ownership or distribution of funds held in escrow?

Review relevant jurisdictional requirements for compliance?

- Trust account rules can vary by state, so it's important to review and follow all applicable local bar, court, and ethics rules.

Conclusion

Holding funds in escrow should never be deemed a simple task or just part of the client representation. Money matters are rife for disagreement, on-going dispute and allegations of error against the attorney or law firm involved. It is critical that law firms educate clients on their options related to escrow, educate clients on the escrow agreement, warn them of challenges that may arise and paths for resolution. When client dreams are directly connected to funds held in escrow, attorneys must have a protocol in place for how the money will work over the course of the representation, including when challenges arise related to the escrow funds.

This article was authored for the benefit of CNA by:

Theresa Garthwaite

Theresa Garthwaite serves as Risk Control Senior Consultant for CNA's Lawyers Professional Services program. She is responsible for the overall assessment, evaluation and delivery of risk control services for complex risk exposures within CNA's Lawyers Professional Liability business. She is responsible for developing risk control content for presentations and publications. She oversees the "In Practice … with CNA" and "CNA's Professional Counsel" publications. Prior to joining CNA, Theresa worked as an associate in a boutique law firm, specializing primarily in plaintiffs' medical malpractice, catastrophic personal injury and wrongful death matters. She is admitted to practice in Illinois and United States District Court, Northern District of Illinois. Theresa also holds the Commercial Lines Coverage Specialist (CLCS) designation, and is a recipient of the Risk Control Superior Service Award.

Don't Miss Out on Future CNA LPL Publications

If you wish to receive the CNA Lawyers' Professional Liability Risk Control monthly publications, you may register here.

About CNA Professional Counsel

This publication offers advice and insights to help lawyers identify risk exposures associated with their practice. Written exclusively by the members of CNA's Lawyers Professional Liability Risk Control team, it offers details, tips and recommendations on important topics from client misconduct to wire transfer fraud.

For more information, please call us at 866-262-0540 or email us at lawyersrisk@cna.com