

Ethics Opinion No. 86-4

Attorney's Duty when Dispute Arises Concerning the Rights of Third Parties to Client Funds in the Possession of Attorney, and Vacating Opinion No. 80-1 in Part.

The Committee has been asked about, or has been involved in, several situations recently involving disputes concerning the rights of third parties to client funds in the hands of the client's attorney. All the situations faced by the Committee have dealt with disputes between the client and a third party over entitlement to the funds. Disputes could also arise, however, between two third parties. These situations involve potentially grave ethical, legal, and practical consequences for the attorney, as illustrated by some of the situations in which the Committee has been involved.

The Committee has recently been asked about, or involved, in the following four situations:

(1) The client suffered significant personal injury in an accident, was treated at a hospital, and incurred substantial medical expenses. The client paid the hospital for only a portion of the amount due on discharge. The client gave the hospital a specific assignment, on a standard hospital form, assigning client's proceeds from settlement or judgment to the hospital in the amount of the balance due.

Thereafter, the client retained the attorney to represent the client's interests in litigation as against possible responsible defendants. Settlement was reached after approximately one year of litigation. Settlement terms included payment of three installments of settlement funds over a two-year period. On specific written instruction from client, attorney disbursed the first two installments of settlement proceeds belonging to client to other assignees. Thereafter, the hospital notified the attorney of the existence of the signed assignment form. Attorney then contacted client to inquire of client as to how proceeds were to be distributed, advising client as to client's liability for unpaid hospital bills. The client specifically instructed the attorney to pay the final settlement proceeds directly to the client, and not to pay the hospital bill, notwithstanding the specific assignment.

(2) Client changed attorneys in the middle of a proceeding. The client apparently agreed to an attorney's lien to secure compensation to the first attorney, and the first attorney filed a claim of lien in the court file in accord with AS 34.35.430. The second attorney subsequently settled the client's case. The client requested payment of the full amount of the settlement proceeds from the second attorney. The second attorney turned over the funds to the client, in accord with the client's request. Litigation brought, by the first

attorney against the second attorney for failure to recognize the attorney's lien is presently pending.

(3) An attorney representing a tort defendant had retained money in his trust account for the purpose of funding a settlement with the plaintiff. Settlement negotiations had taken place, and draft settlement agreements had been prepared. At this point, the client was arrested on a felony charge in another jurisdiction, and requested that his attorney send him the funds which were intended to fund the settlement, so that the client could retain counsel to defend himself against the criminal charge. The attorney sent the funds to the client in accord with the client's request, so that the client could retain counsel. Subsequently, a dispute arose as to whether or not there was a settlement, and whether the funds should have been retained by the attorney in trust to fund the settlement rather than returned to the client. This matter became the subject of an extended investigation by the Alaska Bar Association.

(4) Attorney represents client in a personal injury action. Prior to settlement, client assigned a portion of the settlement proceeds to a third party as down payment on a house. The attorney has a letter of assignment in his file. The client has left Alaska, is in default on his house payments, and foreclosure is likely. The client may have a cause of action against the seller arising out of the transaction. The personal injury case has settled, and attorney is holding the proceeds of the settlement. The client has instructed the attorney to ignore the assignment and pay all funds to the client. If the attorney recognizes the assignment, client will receive nothing.

The foregoing are actual situations presently existing, and illustrate the problems in this area and the need for careful consideration by an attorney when faced with competing demands for funds in the attorney's possession. Generally, the entitlement to these funds is determined as a matter of law, rather than as a matter of ethics. The ethical question is whether or not the attorney must follow the direction given by the client as to the disbursal of funds. The purpose of this opinion is to provide some guidance to the attorney faced with this type of problem.

It is the opinion of the Committee that if a dispute arises concerning the rights of third parties to the client's funds, the attorney must segregate the amount in dispute until the dispute is resolved. If it is impossible to resolve the dispute amicably, then the attorney may pay the funds into the court, and request that the court determine the legal entitlement to the funds.

DR 9-102(B)(4), provides:

A lawyer shall promptly pay or deliver to the client as requested by a client the funds, securities, or other properties in the possession of the lawyer which the client is entitled to receive.

Model Rule of Professional Conduct 1.15 provides:

Rule 1.15 Safekeeping Property

(a) A lawyer shall hold property of clients or third persons that is in a lawyer's possession in connection with a representation separate from the lawyer's own property. Funds shall be kept in a separate account maintained in the state where the lawyer's office is situated, or elsewhere with the consent of the client or third person. Other property shall be identified as such and appropriately safeguarded. Complete records of such account funds and other property shall be kept by the lawyer and shall be preserved for a period of five years after termination of the representation.

(b) Upon receiving funds or other property in which a client or third person has an interest, a lawyer shall promptly notify the client or third person. Except as stated in this Rule or otherwise permitted by law or by agreement with the client, a lawyer shall promptly deliver to the client or third person any funds or other property that the client or third person is entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding such property.

(c) When in the course of representation a lawyer is in possession of property in which both the lawyer and another person claim interests, the property shall be kept separate by the lawyer until there is an accounting and severance of their interests. If a dispute arises concerning their respective interests, the portion in dispute shall be kept separate by lawyer until the dispute is resolved.

The Comment to Model Rule 1.15 provides, in part:

Third parties, such as a client's creditors, may have just claims against funds or other property in a lawyer's custody. A lawyer may have a duty under applicable law to protect such third-party claims against wrongful interference by the client, and accordingly may refuse to surrender the property to the client. However, a lawyer should not unilaterally assume to arbitrate a dispute between the client and the third party.

The obligations of a lawyer under this Rule are independent of those arising from activity other than rendering legal services. For example, a lawyer who serves as an escrow agent is governed by the applicable law relating to fiduciaries even though the lawyer does not render legal services in the transaction.

The operative factor under both the Code and Model Rules is that the client be "entitled to the funds." Neither the Code nor Model Rules, however, provide any guidelines an attorney use to determine whether or not a client is entitled receive funds or property in the attorney's possession. The American Bar Association has addressed the issue of when a client is entitled to funds or

properties under DR 9-102(B)(4). The ABA has suggested that when there is a conflict between an attorney and a client about who is entitled to funds in an attorney's possession, and when this conflict is not quickly and amicably resolved, an attorney may properly file an action for the adjudication of the rights of all claimants. (ABA Informal Opinion 137 August 10, 1976).

Judicial resolutions of these disputes is sometimes necessary. If the attorney is legally incorrect in disbursing funds in accord with the client's request, the attorney may end up paying twice. For example, an attorney may be liable for conversion when the attorney disburses funds to a client with the knowledge of the existence of a lien on the funds. (e.g. *Unigard Insurance Co. v. Tremont*, 37 Conn. Super. 596, 430 A.2d 30 (1981); *In Re Cassidy*, 89 Ill. 2d 145, 432 N.E.2d 274 (1982))

A related issue is the lawyer's duty to third-party creditors of client regarding client's funds. This issue has not directly been addressed by the ABA Code or the ABA Model Rules. The cases and ethics opinions on this issue, usually involving outstanding medical expenses, have varied. For instance, Alaska Opinion 80-1 (1980) held that an attorney did not violate any ethical obligation by forwarding funds received to the client knowing that the client had outstanding medical bills. A slightly different position was taken in Delaware Opinion 1981-3 (Apr. 21, 1981), which held that an attorney should try to persuade the client to pay medical expenses, but may not force the client to do so. A third position was adopted in South Carolina Opinion 81-14 (1981). Under this Opinion, an attorney should request permission from the client to pay outstanding medical expenses. Furthermore, if the client refuses permission, the attorney will hold the funds for a short designated period of time without disbursement. *See also In Re Cassidy*, 89 Ill.2d 145, 432 N.E.2d 274 (1982) (not improper for lawyer to delay disbursement of funds to client when lawyer reasonably believed client's creditors had superior claim to funds).

The Greater Cleveland Bar Association has recently issued an opinion in a case in which a woman had hired an attorney to draft a prenuptial agreement for her, dealing with her real property. The agreement was signed, and the parties were married. Subsequently, the husband retained the attorney to prepare a deed to convey to the wife a 1/2 interest in his residential real property, the marital home. The deed was executed, witnessed, and notarized. The husband subsequently called and instructed the attorney not to record the deed until given further instructions. Fifteen months later, the husband demanded that the attorney give him the deed. The attorney was unable to contact the wife, and anticipated litigation from the wife if he turned the deed over to the husband. In this situation, the Greater Cleveland Bar Association indicated that the attorney's course becomes a mandatory one of disclosure, notice, and hopefully consent by both husband and wife to the disposition of the deed. If consent is not possible, then agreed upon arbitration or judicial

intervention must be obtained. (Greater Cleveland Bar Association Professional Ethics Committee, Opinion 85-2, December 13, 1985, reported in ABA/BNA Lawyers Manual and Professional Conduct, January 8, 1986, at page 1121)

With respect to situation (1), involving the hospital bills, the Committee has been asked the following questions:

Query A: Has hospital established sufficient grounds to enforce a lien for payment pursuant to AS 34.35.450-34.35.480?

Query B: Should attorney pay the hospital bill pursuant to assignment or subscribe to the wishes of the client and forward final settlement proceeds to client directly?

Query C: Is attorney personally liable to either hospital or client for opting to pay one, and not the other?

Query D: Is written instruction from client directing direct payment to client sufficient to protect attorney from personal liability under the statute?

Whether or not a lien for payment has been established is a question of law, upon which the Committee cannot issue an opinion. If the attorney unilaterally makes an incorrect decision to pay either the hospital or the client, the attorney may very well be held personally liable for failure to pay the other. Written instruction from the client will probably not absolve the attorney from liability for failure to recognize a valid lien or assignment.

If there were no dispute as to the client's "entitlement" to the funds, the attorney would be ethically obligated to pay the funds to the client upon demand. If there is a dispute over whether or not the client is "entitled" to the funds, then it is necessary that the dispute be resolved.

The question of whether a client is "entitled" to funds in the possession of an attorney is most often a question of law, which will often require findings to be made which are based on disputed facts. If the attorney has any doubt as to whether the client is entitled to the funds, or the attorney reasonably anticipates potential personal liability in a situation where there is a dispute over the client's funds, then the attorney should ascertain if the dispute can be resolved amicably between the claimants to the funds. If the claimants cannot agree, then the attorney may seek judicial resolution of the dispute.

The same reasoning applies to situation (4), except that the legal question deals with failure to recognize a valid assignment only, without the additional problem of possible failure to recognize a statutory lien. The attorney here should also first ascertain whether the dispute can be amicably resolved

between the conflicting claimants. Failing that, then the attorney may seek judicial resolution of the dispute.

Based on the foregoing, that portion of Alaska Ethics Opinion No. 80-1 which deals with the ethical responsibility of an attorney to pay known medical bills (Question 1 and its answer) is vacated.

Adopted by the Alaska Bar Association Ethics Committee this 4th day of November, 1986.

Approved by the Board of Governors on November 7, 1986.

**ALASKA BAR ASSOCIATION
ETHICS OPINION NO. 92-3**

**Clarification of Ethics Opinion 86-4
Regarding Attorney's Duty When Dispute Arises
Concerning the Rights of Third Parties
to Client Funds in the Possession of Attorney**

A number of questions have arisen regarding the scope of Opinion 86-4, and the circumstances under which an attorney may be held responsible for failing to honor a claim by a third party against client funds in the possession of the attorney.

It is the opinion of the Committee that: (1) In order to trigger an obligation on the part of the attorney to pay a creditor's claim, in contravention of a client's instructions, the creditor's claim must be a valid assignment on its face or statutory lien which has been brought to the attorney's attention.¹ (2) If a client instructs an attorney to ignore or disregard a valid assignment or statutory lien, the attorney should advise the client that absent an explanation (e.g., a written release, or some other form of written waiver by the lienor or assignee) the attorney will withhold the disputed funds, and, absent some amicable resolution, the funds will be deposited into court where the dispute can be decided by the judge.

A. WHAT THIRD PARTY CLAIMS MUST BE HONORED?

This is another way of asking the question when is the attorney obligated to deliver to the client funds "which the client is entitled to receive." See DR9-102(b)(4) (emphasis added). The Committee believes that when a client executes a valid assignment from settlement proceeds, or there exists a perfected statutory lien against settlement proceeds, it creates a presumption that the client is not "entitled" to those funds. Bonanza Motors, Inc. v. Webb, 657 P.2d 1102 (Id. App. 1983); Herzog v. Riace, 594 A.2d 1106 (Me. 1991).

There may be other claims unrelated to the subject matter of the representation; for instance child support, alimony, restitution for criminal conduct and so on. "However, a lawyer should not unilaterally assume to arbitrate a dispute between the client and the third party." See Comment to Model Rule

¹ However, practitioners should be aware that under some tax lien statutes, the statutory filing requirements provide the element of notice. See 26 U.S.C. § 6321.

1.15.² A client is capable of and responsible for payment of his or her own obligations. Unless the claim in question has been reduced to a valid assignment or perfected lien, a creditor has no more special "entitlement" to those funds than does the client. The creditor in that situation has other remedies, such as prejudgment attachment. See Alaska R. Civ. P. 89. However, where a settlement includes or references specific allocation for a lien claimed by a third party, the amount designated for satisfaction of the lien must be utilized for that purpose. In re Burns, 679 P.2d 510 (Az. 1984).

B.

WHEN DOES A DISPUTE ARISE OVER THE CLIENT'S ENTITLEMENT TO HIS OR HER FUNDS, AND HOW SHOULD THOSE DISPUTES BE RESOLVED

In the view of the Committee, if a client instructs an attorney to disregard the terms of a valid assignment or statutory lien, the attorney should promptly inform the client that the attorney is obligated to withhold and segregate those funds in question. Unless the client and the creditor are able to amicably resolve their differences, or unless the client provides the attorney with some verification that the lienor or assignee have waived their interest in those funds, the attorney will be required to deposit the funds into court for disposition by the judge. Given the fact that both sides will incur expense and delay in the event this step is taken, it would be appropriate to encourage the client and the creditor to resolve their differences promptly and amicably.

C. THE ATTORNEY SHOULD BE CAREFUL NOT TO INDUCE RELIANCE ON THE PART OF THE THIRD PARTY CREDITOR

Any number of questions may arise regarding a client's "entitlement" to funds being held by the attorney. The Committee believes that care should be taken to dispel any confusion which might arise regarding the attorney's obligations under these circumstances.

If, for instance, an attorney receives a letter from a medical provider to the effect that he or she is owed money for services provided to the client relating to the subject matter in question, that does not, in the Committee's view, create a presumption that the client is not entitled to receive the funds in question at his or her request. However, the Committee believes that the attorney in that instance should respond to the letter and convey to the medical provider the fact that this is a matter between the client and the medical provider. The medical provider should be on notice that the attorney will not be assuming the responsibility for payment of the client's bills relating to the subject matter in question; that is the client's responsibility.

The Committee believes it is inappropriate for the attorney to remain silent after having received notice of such a potential claim. While the attorney may believe that his or her silence in the face of receiving such notice is or may be interpreted as a constructive denial of the creditor's position, it is just as likely that the third party creditor may view that silence as implicit or tacit acceptance of the third party claim.

The situation is ripe for confusion, and the Committee believes the attorney should take the affirmative step of responding to these claims by shifting the burden back where it belongs, namely on the third party creditor and the client.

² The Model Rules of Professional Conduct have been approved by the Alaska Board of Governors and are currently pending before the Alaska Supreme Court.

In conclusion, the Committee believes that an attorney is not ethically obligated to arbitrate claims between creditors and his or her client. With respect to third party creditors who have not received an assignment from the client, or who have not perfected a statutory lien, and assuming the attorney has followed the recommendations outlined in Section C above and informed the creditor that the claim should be taken up directly with the client, the attorney should be free to follow the client's instructions with respect to return of client property. Even though the attorney may be aware of a potential problem in this regard, the Committee does not believe this vitiates the client's "entitlement" to return of his or her property, pursuant to DR 9-102(B)(4).

If a client instructs an attorney to disregard the terms of a valid assignment or statutory lien, the attorney should promptly take the appropriate steps to segregate those funds in question, and to inform the client that, absent a resolution which is satisfactory to all parties concerned, the attorney will be obliged to deposit the funds into court for disposition by the judge.

Approved by the Alaska Bar Association Ethics Committee on
April 2, 1992.

Adopted by the Board of Governors on June 1, 1992.

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