

FORMAL OPINION NO 2005-52

Client Funds:

Obligation of Lawyer to Client Creditors and PIP Carrier

Facts:

Lawyer represents Plaintiff in motor vehicle personal-injury litigation. During the course of the litigation, Plaintiff receives PIP benefits from Plaintiff's Insurer.

Also during the course of the litigation, Lawyer receives a telephone call from Doctor, who provided medical services to Plaintiff that were not covered by PIP benefits and for which Doctor has not been paid, and from Miscellaneous Unsecured Creditor. After discussing the matter with Plaintiff and obtaining Plaintiff's authorization to do so, Lawyer tells Doctor and Miscellaneous Unsecured Creditor that to the extent funds in excess of legal fees and costs are received after trial or in settlement, Lawyer will pay Doctor and Miscellaneous Unsecured Creditor.¹

Lawyer also learns during the course of the litigation that Secured Creditor has a valid and perfected security interest in a portion of the potential proceeds from the litigation.

Lawyer settles the case and receives funds sufficient to pay Lawyer's outstanding fees and expenses plus Secured Creditor, Doctor, and Miscellaneous Unsecured Creditor. Plaintiff then demands that Lawyer forward all funds received other than those necessary to pay Lawyer's fees and costs to Plaintiff and that Lawyer not pay Secured Creditor, Doctor, or Miscellaneous Unsecured Creditor.

¹ This opinion does not address a situation in which Lawyer may have made payment representations to Doctor or Miscellaneous Unsecured Creditor without Client's knowledge or consent. This opinion also does not address Lawyer's direct contractual obligations, if any, to creditors.

Question:

What are Lawyer's ethically available options?

Conclusion:

See discussion.

Discussion:

Oregon RPC 1.15-1(d) provides:

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.

Oregon RPC 1.15-1(e) provides:

When in the course of representation a lawyer is in possession of property in which two or more persons (one of whom may be the lawyer) claim interests, the property shall be kept separate by the lawyer until the dispute is resolved. The lawyer shall promptly distribute all portions of the property as to which the interests are not in dispute.

From the text of Oregon RPC 1.15-1(d) as quoted above, it is only funds "that the client . . . is entitled to receive" that a lawyer must pay to a client, and funds "that [a] third person is entitled to receive" must be paid to the third person. *Cf. In re Howard*, 304 Or 193, 743 P2d 719 (1987) (discussing former DR 9-102(A), renumbered DR 9-101(A) in 1985). It is also clear from the text of Oregon RPC 1.15-1(e) that it is only funds whose ownership is in dispute that a lawyer may "ke[ep] separate . . . until the dispute is resolved." *Cf. In re Eakin*, 334 Or 238, 48 P3d 147 (2002) (lawyer disciplined for, *inter alia*, failing to return to client the unearned portion of retainer when requested); *In re Gallagher*, 332 Or 173, 26 P3d 131 (2001) (stating that former disciplinary rule

governed only handling of client money rather than third-party funds, and overpayment in question was not client money).

The question to be addressed is who is “entitled to receive” these funds within the meaning of Oregon RPC 1.15-1(d). We are presently aware of no Oregon Supreme Court authority that addresses this question. Absent such authority, we believe it is appropriate to consider comment [4] of ABA Model RPC 1.15:

Paragraph (e) also recognizes that third parties may have lawful claims against specific funds or other property in a lawyer’s custody, such as a client’s creditor who has a lien on funds recovered in a personal injury action. A lawyer may have a duty under applicable law to protect such third-party claims against wrongful interference by the client. In such cases, when the third-party claim is not frivolous under applicable law, the lawyer must refuse to surrender the property to the client until the claims are resolved. A lawyer should not unilaterally assume to arbitrate a dispute between the client and the third party, but when there are substantial grounds for dispute as to the person entitled to the funds, the lawyer may file an action to have a court resolve the dispute.

We also believe it is appropriate to consider *Restatement (Third) of the Law Governing Lawyers* § 45 (2000) (supplemented periodically):

(1) Except as provided in Subsection (2), a lawyer must promptly deliver, to the client or nonclient so entitled, funds or other property in the lawyer’s possession belonging to a client or nonclient.

(2) A lawyer may retain possession of funds or other property of a client or nonclient if:

(a) the client or nonclient consents;

(b) the lawyer’s client is entitled to the property, the lawyer appropriately possesses the property for purposes of the representation, and the client has not asked for delivery of the property;

(c) the lawyer has a valid lien on the property (see § 43);

(d) there are substantial grounds for dispute as to the person entitled to the property; or

(e) delivering the property to the client or nonclient would violate a court order or other legal obligation of the lawyer.

The official comments to this section provide, in pertinent part:

d. Disputed ownership. When it is unclear who is entitled to property in the lawyer's possession, the lawyer is not required to deliver the disputed property to either claimant; indeed, if the lawyer delivers the property to one claimant, the lawyer can later be held liable to the other. The lawyer should therefore safeguard the property until the disputants resolve it by contract or an appropriate procedure. . . . If a lawyer holds property belonging to one person and a second person has a contractual or similar claim against that person but does not claim to own the property or have a security interest on it, the lawyer is free to deliver the property to the person to whom it belongs. If a lawyer holds funds as an advance fee payment, the lawyer is not obliged to deliver those funds to the client when the client disputes the lawyer's good-faith claim that the sum withheld is due to the lawyer, but the lawyer may not transfer the disputed funds to the lawyer's personal account. . . .

e. A court order or other legal bar to delivery. A court may order a lawyer to deposit property in court or in an interest-bearing account pending further court orders. A court might also require a lawyer to surrender an object to another party or allow its inspection at the lawyer's office, regardless of the wishes of the lawyer's client. Such a court order ordinarily binds a client's lawyer even if only the client is named in the order. A lawyer might also be constrained by a legal obligation not arising from a court order, for example a lien asserted by a third party. A lawyer is not required by any supposed duty to a client to deliver property to a claimant when doing so would cause the lawyer to violate a court order or other legal obligation.

Restatement (Third) of the Law Governing Lawyers § 45 cmts d & e.

As a matter of law, Secured Creditor's valid and perfected security interest entitles Secured Creditor to receive funds to the extent necessary to satisfy the security interest. That being so, the funds subject to Secured Creditor's valid and perfected security interest are funds that a third person—Secured Creditor—is entitled to receive and that may be properly paid only to Secured Creditor and not to client Plaintiff pursuant to Oregon RPC 1.15-1(d). The same would be true if Secured Creditor's lien were statutory rather than contractual in origin. If there is a non-

frivolous dispute with regard to the amount to which Secured Creditor is entitled, Lawyer would be obligated by Oregon RPC 1.15-1(e) to retain the disputed portion, or perhaps implead it, until the dispute was resolved, but must pay the undisputed portion to Secured Creditor.

As to Doctor and Miscellaneous Unsecured Creditor, who have neither statutory liens nor contractual security interests, the question is who, as between Client and the creditors, has the legal right to the funds. In the absence of definitive authority construing the phrase *entitled to receive*, we conclude that Lawyer may retain or implead the funds claimed by Doctor and Miscellaneous Unsecured Creditor if Lawyer concludes that there is a nonfrivolous dispute regarding entitlement to the funds. This conclusion may require, for example, that Lawyer ask Plaintiff the basis for Plaintiff's new instruction and whether Plaintiff simply wishes to postpone or perhaps avoid payment to Plaintiff's creditors on the one hand or to engage in a bona fide dispute regarding Doctor's or Miscellaneous Unsecured Creditor's right to be paid on the other. Lawyer should also consider the extent, if any, to which Lawyer's representations about payment to Doctor and Miscellaneous Unsecured Creditor may have created enforceable contract rights on their part. Furthermore, Lawyer should assess whether Lawyer's transfer of funds to Plaintiff would constitute a fraudulent transfer within the meaning of ORS chapter 95 or similar bankruptcy law provisions. *Compare In re Hockett*, 303 Or 150, 734 P2d 877 (1987) (lawyer's assistance to client in making fraudulent transfer constituted both impermissible illegal conduct and impermissible conduct involving dishonesty, fraud, deceit, or misrepresentation), *with In re Taylor*, 319 Or 595, 878 P2d 1103 (1994) (insufficient proof of either violation in connection with alleged fraudulent transfer), *and In re Norman*, 17 DB Rptr 9 (2003) (not all fraudulent transfers involve illegal or dishonest conduct).

May Lawyer simply give the funds to Plaintiff regardless of Lawyer's prior representations to Doctor and Unsecured Creditor? In the absence of a definitive construction of the words *entitled to receive*, we believe that Lawyer may do so unless Lawyer's actions would constitute "illegal conduct" in violation of Oregon RPC 3.3(a)(5) or conduct involving "dishonesty, fraud, deceit or misrepresentation" in violation of

Oregon RPC 8.4(a)(4). In *In re Williams*, 314 Or 530, 840 P2d 1280 (1992), the Oregon Supreme Court held that a lawyer who had informed his client's landlord that rental funds were being held in trust was obligated to inform the landlord when the lawyer, at the client's request, decided to return the rental funds to the tenant. The court did not address whether the lawyer should or should not be faulted for returning the funds to the client as requested. Nor does the opinion address whether or under what circumstances the lawyer would have been obligated to give advance notice to the landlord before returning the funds. More recently, in *In re Carpenter*, 337 Or 226, 95 P3d 203 (2004), the court emphasized the public interest in the integrity and trustworthiness of lawyers even when they are dealing with persons other than clients.

In short, the proper disposition of clients' funds under circumstances such as are present here will likely depend on the assessment of additional facts above and beyond those present in this opinion. It should be clear, however, that Lawyer may not give to Plaintiff funds that are subject to a valid lien or other claim to the specific funds, although if Plaintiff can assert a nonfrivolous dispute as to the amount or validity of such a claim, Lawyer may hold the funds pending resolution of the dispute or implead the funds for a court to decide. Lawyer may distribute to Plaintiff any funds not subject to liens or other legal claims, if doing so does not constitute illegal or dishonest conduct.

Approved by Board of Governors, August 2005.

COMMENT: For additional information on this general topic and related subjects, see *The Ethical Oregon Lawyer* § 12.3-7(a) to § 12.3-7(c) (receipt of client funds and disbursing funds from a lawyer trust account), § 12.4-1 (notification, handling, and distribution of client property in general), § 16.4-7 (improper handling of settlement proceeds) (OSB Legal Pubs 2015); *Restatement (Third) of the Law Governing Lawyers* §§ 43–45 (2000) (supplemented periodically); and ABA Model RPC 1.15.