

NEW HAMPSHIRE BAR ASSOCIATION
Ethics Committee Formal Opinion #1998-99/3
Safeguarding Settlement Funds of Clients and Third Parties:
Recognized Valid Liens on Settlement Funds in Lawyer's Possession
February 24, 1999

Presented to the Board of Governors May 20, 1999

RULE REFERENCES:

- * Rule 1.15(a)
- * Rule 1.15(b)
- * Rule 1.15(c)

CODE REFERENCES:

*None

SUBJECTS:

- * Safeguarding Funds & Property of Clients and Third Parties
- * Valid Liens on Settlement Funds in Lawyer's Possession

ANNOTATIONS:

- *A lawyer has an ethical obligation to notify, separate and deliver settlement funds in the lawyer's possession to a lienholder who has a recognized valid lien. (Rule 1.15(a); Rule 1.15(b)).
- * If a dispute arises concerning settlement funds in a lawyer's possession, the lawyer has an ethical obligation to keep the funds separate until the dispute is resolved by agreement or decision. (Rule 1.15(c)).

I. QUESTION:

What ethical obligations does a lawyer have to a lienholder who has a recognized valid lien on settlement funds in the lawyer's possession?

II. FACTUAL SETTING:

During the process of settling a personal injury claim on behalf of an injured client, a lawyer will often recognize and agree with a third party, who has provided medical or other benefits to the injured client, to protect the lienholder's valid statutory interest in the settlement proceeds in exchange for reducing the lien amount. Ordinarily, the lienholder will be paid promptly out of settlement proceeds received by the lawyer without incident. However, if a dispute arises regarding the lienholder's interest in settlement proceeds in the lawyer's possession, the lawyer can be presented with a perplexing predicament.

A recent inquiry was presented to the Ethics Committee in which a lawyer for an injured party agreed with a third party, which had provided medical insurance benefits to the injured client, to protect the lienholder's statutory interest in settlement proceeds in exchange for reducing the lien amount by one-third. Upon receipt of the settlement funds, the lawyer provided the lienholder with a check from the lawyer's trust account for payment of the agreed-upon reduced lien amount. For reasons that are unclear, the lienholder failed to negotiate the trust account check. The attorney

contacted the lienholder on several occasions and requested the lienholder to deposit the trust account check. Still, the check was not cashed by the lienholder. More than three years later, the lawyer contacted the lienholder and attempted to renegotiate the lien amount by proposing to distribute half of the trust funds to the lienholder and the other half to the client, after the lawyer was paid a reasonable amount from the funds for efforts related to the trust account funds during the past three years. The lawyer noted that the statute of limitations probably expired relative to a possible collection action against the client or a breach of contract action against the lawyer. When the lienholder refused to renegotiate the reduced lien amount, inquiry was made to the Ethics Committee as to the attorney's ethical obligations, if any, to the lienholder.

III. RESPONSE:

A. **Fiduciary Duty and Ethical Obligations**

A lawyer who holds property belonging to another, including settlement funds, must exercise the care of a fiduciary. Rule 1.15, Comments to the ABA Model Code of Professional Responsibility ("ABA Code Comments"). "An attorney who accepts the responsibility of a fiduciary nature is held to the high standards of the legal profession whether or not he acts in his capacity of an attorney." ANNOT. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.15 (1997), at 234 ("ABA Annotated Model Rules"), citing Ridge v. State Bar, 766 P.2d 569 (Cal. 1989) (quoting Worth v. State Bar, 551 P.2d 16 (Cal. 1976)).

Rule 1.15 Safeguarding Property, of New Hampshire's Rules of Professional Conduct (1997) ("New Hampshire Rules") addresses a lawyer's ethical obligations with regard to receiving, safeguarding and distributing settlement funds in the lawyer's possession. The ethical obligations reflect a lawyer's fiduciary duty concerning such funds. The fiduciary duty and ethical obligations concerning such funds include segregation, notification, recordkeeping, delivery, and accounting, and extend not only to the lawyer's client, but also to a third party lienholder who has a recognized valid lien on such funds. Law. Man. on Prof. Conduct (ABA/BNA) No. 179, at 45:1101 - 45:1115 (1997); ABA Annotated Model Rules, Rule 1.15, at 234-244; RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS, §§ 56-57 (Proposed Final Draft No. 1 Mar. 29, 1996) ("Restatement of the Law Governing Lawyers"); C.W. WOLFRAM, MODERN LEGAL ETHICS § 4.8, at pp. 175-182 (1986) ("Wolfram")

B. **Settlement Funds in Lawyer's Possession**

Lawyers who receive settlement (or judgment) funds on behalf of a client oftentimes are aware of a valid statutory lien on such funds, and negotiate with the lienholder to compromise the lien amount in exchange for agreeing to protect the lienholder's interest in the settlement funds. If the lawyer agrees to protect a lienholder's interest, or is aware of an agreement made by the client with a lienholder, the lawyer has an ethical obligation to promptly notify the client and lienholder upon receiving such funds; to separate, deposit and account for such funds into appropriate trust accounts; and to deliver the funds as permitted by law, agreement or Rule 1.15.

Rule 1.15(a) of the New Hampshire Rules and Rule 1.15(a) of the ABA Model Rules expressly extend to a third person who has a valid and recognized interest in any settlement and/or judgment funds held by the lawyer, and mandate the lawyer's ethical obligations of separation, deposit and accounting of such funds received by the lawyer.

While New Hampshire Rule 1.15(b) does not expressly extend the lawyer's obligations of prompt notification and delivery concerning such funds to third persons, as does the ABA Model Rule 1.15(b),

Sections 56 and 57 of the Restatement of the Law Governing Lawyers do expressly extend such obligations to a third person who has a valid and recognized interest in such funds. Further, the ABA Code Comments recited at New Hampshire Rule 1.15 expressly recognize that "[t]hird 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."

Clearly, the spirit of the New Hampshire Rule 1.15 is to require lawyers to handle funds and property of others in the lawyer's possession as fiduciaries. Thus, while New Hampshire's version of Rule 1.15(b) does not expressly recite obligations to third persons, ethical obligations do extend to a known and recognized third person who has a valid lien or agreement by implication. See Wolfram, § 4.8, at p. 178 ("Because the professional fiduciary rules apply generally, most courts have not been impressed with arguments that the requirements of the professional rules should be narrowly applied to client-lawyer relationships and have applied the rules even if the lawyer was . . . holding funds of a third party who is not the lawyer's client. The general rule of [Rule 1.15(a)] limits the fiduciary rules to funds or property that comes into a lawyer's possession 'in connection with a representation' but seems subject to an equally broad interpretation. Under both the Code and Model Rules, the general prohibitions against dishonesty would also suffice to cover most instances of conversion of client or third party funds or property."). Consequently, a lawyer should promptly notify and deliver to a third person, who has a recognized and valid lien or agreement concerning settlement funds, that portion of such funds to which the third person is legally entitled.

New Hampshire Rule 1.15(c) requires property in which a lawyer and any other person (client or third party) claim an interest to be kept separate by the lawyer until an accounting and severance occur. If a dispute arises concerning such funds, the separate account for the funds must be maintained until the dispute is resolved by agreement or decision. Furthermore, if a third person, such as a client's creditor, has a valid lien against settlement funds held by the lawyer, the lawyer may have a duty under state law to protect the valid third party lien against wrongful interference by the client.

In other jurisdictions, ethics opinions and court decisions have declared that if a non-client has a recognized and valid lien, agreement or contract, or Court Order that grants an interest in a client's settlement funds or property, a lawyer may not ignore the third person's interest and deliver the contested property to the client. See In re Hodge, 676 A.2d 1362 (R.I. 1996) (attorney violated Rule 1.15(b) duty to third person by withholding sums from settlement to pay medical bill lien and converting to own use); Arizona Ethics Opinion, 97-02 (1997) (lawyer must notify insurer of settlement and deliver subrogated funds to the insurer which provided health care for client following accident where insurer had statutorily created subrogation right); California Formal Ethics Opinion, 1988-101 (lawyer whose client agreed to pay recovery proceeds to health care provider may not ignore agreement and disburse all money to client upon client's request); Maryland Ethics Opinion, 94-19 (1993) (lawyer must disregard client instruction not to pay creditor where client had valid agreement with creditor); Ohio Ethics Opinion, 95-12 (1995) (lawyer must disregard client's instructions not to pay physician from proceeds where client had agreement to pay medical expenses from such proceeds); South Carolina Ethics Opinion, 94-20 (1994) (if lawyer knows client executed valid doctor's lien, he may not comply with client's instructions that lawyer disregard it; no principle of client loyalty or confidentiality permits a lawyer to violate the ethical obligations to third persons of notification and delivery); Aetna Casualty and Surety Co. v. Gilreath, 625 S.W.2d 269 (Tenn. 1981) (lawyer under duty to recognize lien of client's employer on worker's compensation recovery proceeds); In Re Shannon, 876 P.2d 548 (Ariz. 1994) (lawyer's deposit of check in satisfaction of judgment, without executing

satisfaction of debt, is conduct prejudicial to the administration of justice); Unigard Ins. Co. v. Tremont, 37 Conn. Supp. 596, 430 A.2d 30 (1981) (where insured possessed statutory lien on judgment proceeds, lawyer's disbursement of funds to client constituted conversion); In Re Cassidy, 89 Ill. 2d 145, 432 N.E.2d 274 (1982) (not improper for lawyer to delay disbursement of funds to client where lawyer reasonably believed client's creditors had superior claim to funds); see also Conn. Bar Assoc. Comm. On Professional Ethics, Informal Op. 95-20 (1995) (mere assertion of claim insufficient to create duty; however, situations may demand that lawyer deliver property to third party: (1) lawyer knows of valid judgment concerning disposition of property, (2) lawyer knows of valid statutory judgment lien against property, (3) lawyer knows of letter of protection or similar obligation directly related to property and specifically entered into to aid lawyer in obtaining property); Del. State Bar Assoc. Comm. On Professional Ethics, Op. 1981-3 (1981) (lawyer has ethical obligation to persuade client to pay outstanding medical bills, but cannot force or demand that client pay expenses from settlement or judgment proceeds); ABA Comm. On Ethics and Professional Responsibility, Informal Op. 1295 (1974) (lawyer requesting physician's services for client may permit client to sign agreement with physician directing lawyer to withhold from future recovery sums necessary to pay accrued medical bills).

If the lawyer has an agreement with a lienholder and the client regarding disposition of settlement funds, the lawyer must honor that agreement. Florida Bar v. Neely, 587 So. 2d 465 (Fla. 1991) (lawyer paid money directly to client contrary to lawyer's agreement with doctor to pay client's medical bills out of proceeds, thereby failing to advise third party upon receipt of funds in which third party had an interest). If the lawyer ignores the duty owed to a third party and pays the disputed amount directly to the client, the lawyer may be held liable to the non-client. Herzog v. Irace, 594 A.2d 1106 (Me. 1991) (attorneys held liable for breach of assignment; Court rejected lawyer's argument that they must ethically follow client's instruction to ignore valid assignment); Kaiser Foundation Health Plan, Inc. v. Aguiluz, 54 Cal. Rptr. 2d 665 (Cal.Ct.App. 1996); Leon v. Martinez, 638 N.E. 2d 511 (N.Y. 1994); see also Restatement of the Law Governing Lawyers § 56.

On the other hand, a lawyer should not disburse such funds to a third party if the client contests the issue. If there is a legitimate dispute as to the funds, the lawyer should not unilaterally assume to arbitrate the dispute. Instead, the lawyer should set the funds aside until the issue is resolved by agreement or by decision. Rule 1.15(c).

IV. CONCLUSION:

The spirit and intent of New Hampshire Rule 1.15(a), (b), and (c) is to require lawyers to safeguard property of others held in the lawyer's possession, and to act as fiduciaries consistent with all ethical obligations. Once a fiduciary relationship is established regarding such funds or property, ethical obligations transcend the mechanical application of the statute of limitations or the equitable concepts of waiver and estoppel. Accordingly, a lawyer must continue to fulfill all ethical obligations of the fiduciary relationship.

The ethical obligations of Rule 1.15 of New Hampshire Rules require a lawyer to notify, separate, and deliver settlement funds in the lawyer's possession to a lienholder who has a recognized valid lien. If a dispute arises concerning such funds in the lawyer's possession, the lawyer must continue to keep the funds separate until the dispute is resolved by agreement or decision.