Uncomfortable Position: Disputed Third-Party Claims Against Law Firm Trust Accounts

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One of the most uncomfortable positions a litigator can face is a disputed third-party claim against funds held in the law firm’s trust account. Third-party claims can range from statutory liens connected with the litigation involved to writs of garnishment that have no connection to the matter being handled. They cannot be ignored and have the potential to put the lawyer at odds with the client against whom the lien is being asserted. The risks of mishandling third-party claims run from regulatory discipline to potential liability for the funds involved. The Oregon State Bar has provided guidance to lawyers navigating third-party claims, but it is necessarily general and does not offer “bright line” answers to every situation.

This article surveys two interwoven areas when confronted with third-party claims against funds held in a law firm trust account. First, the duties involved when holding disputed funds in trust are surveyed. Second, the procedural mechanisms for depositing the disputed funds into a court for resolution of the competing claims are outlined.

Duties

By definition, funds held in a law firm’s trust account are not the lawyer’s money. RPC 1.15-1(a) puts it this way: “A lawyer shall hold property of clients or
third persons that is in a lawyer’s possession separate from the lawyer’s own property.” Although funds that may ultimately be due the lawyer—such as advance fee deposits and the lawyer’s portion of a joint check from a defendant settling a contingent fee case—must be deposited initially into a trust account, they must be moved to the lawyer’s general account as they are earned under RPC 1.15-1(c)-(d).¹ Therefore, beyond legal fees which have been earned but have not yet been transferred out of a trust account (for example, when work has been done but the resulting bill has not yet been generated²), the funds held in trust in a given matter are typically the client’s property.³ Because they are the client’s property, the funds involved are subject to third-party claims against the client.⁴

Some third-party claims are related to the litigation involved. Medical service liens under ORS 87.555 are a ready illustration in personal injury cases. Others, such as writs of garnishment under ORS 18.615, may be wholly unrelated to the matter being handled. Although many third-party claims are rooted in statutory authority, some are not. Oregon State Bar Formal Opinion 2005-52, for example, discusses contractual obligations to secured and unsecured creditors in this context if the client has agreed to have them satisfied out of funds coming into trust—such as settlement proceeds.

Most third-party claims are satisfied routinely with client consent. Others, however, are disputed. In either event, third-party claims cannot simply be
ignored. Lawyers have been disciplined for mishandling disputed funds. Oregon disciplinary cases include both intentional and negligent mishandling within the ambit of RPC 1.15-1(e) and its predecessor under the former Disciplinary Rules—DR 9-101(A). Moreover, the risk to lawyers extends beyond bar discipline. Depending on the statutory basis for the lien involved, a law firm that does not ensure that a lien is satisfied may be liable for the amount involved. OSB Formal Opinion 2005-52 also discusses scenarios where a lawyer who ignores a valid lien may be subject to liability to the creditor involved for a fraudulent transfer.

RPCs 1.15-1(d) and (e) outline general procedures in the event of a dispute.

RPC 1.15-1(d) generally requires a lawyer to “promptly deliver to . . . [a] third person any funds . . . that the . . . third person is entitled to receive[,]” OSB Formal Opinion 2005-52 notes that the phrase “entitled to receive” has not been interpreted by the Oregon Supreme Court. In the absence of guidance from the Supreme Court, Formal Opinion 2005-52 discusses both the relevant comment to the corresponding ABA Model Rule of Professional Conduct and the analogous section of the Restatement (Third) of the Law Governing Lawyers (2000). Formal Opinion 2005-52 reasons that the wording of RPC 1.15-1(d) suggests that a valid third-party claim can override a client’s contrary instructions and allows a lawyer to disburse the funds involved even if the client objects.
RPC 1.15-1(e), in turn, allows the lawyer instead to keep the disputed funds “separate . . . until the dispute is resolved.” Examining the word “separate,” OSB Formal Opinion 2005-52 counsels that the lawyer can either retain the disputed funds in trust or deposit them into the court concerned pending resolution of the dispute. On a practical level and as will be discussed further in the next section, depositing the funds into the court is often the most prudent approach for two reasons. First, although an experienced personal injury lawyer may be well-equipped to assess the validity of a routine medical lien in a case the lawyer has handled, even seasoned lawyers may not be familiar with the intricacies of liens arising outside their areas of expertise or third-party claims stemming from unrelated matters. In short, the term “entitled to receive” may, at least in some circumstances, be easier to state than apply. Second, Comment 4 to ABA Model Rule 1.15, on which Oregon’s rule is patterned and is the authority cited in Formal Opinion 2005-52, cautions that “[a]lawyer should not unilaterally assume to arbitrate a dispute between the client and the third party[.]” Allowing a court to decide is inherently more protective of the lawyer from the perspective of risk management because it allows both the client and the third-party to present their respective arguments to a neutral decision-maker. RPC 1.15-1(e) also instructs on the appropriate disposition of any undisputed portions: “The lawyer shall promptly distribute all portions of the property as to which the interests are not in dispute.”
**Court Resolution**

The forum for court resolution will ordinarily flow from how the claim involved arose.

If the claimant is a party to current litigation (originally or by intervention in a supplemental proceeding), then depositing the funds into the court involved is the simplest solution. UTCR 1.120 addresses disbursement of money in Oregon state trial courts and, implicitly, recognizes that funds may be deposited. 28 USC §§ 2041-2045 govern the deposit and withdrawal of funds in federal proceedings and Local Rule 67-1 supplements the statutory guidance for the District of Oregon.

If the claimant is not a party to current litigation, both state and federal courts offer the procedural mechanism of interpleader. ORCP 31 governs interpleader in Oregon state trial courts and FRCP 22 and 28 USC § 1335 do the same in federal courts.

If the claim arises through a writ of garnishment, the court issuing the writ effectively provides the venue for depositing funds under ORS 18.668(1).

Two related questions come into play when third-party claims are resolved in court.

First, should the lawyer represent the client on that claim? The answer will often turn on the nature of the claim. It is comparatively common for plaintiffs’ personal injury lawyers to negotiate with holders of medical liens in an
effort to discount those liens for the benefit of the lawyer’s client. Those are
typically situations, however, where there is no dispute over the face amount or
validity of the lien, the lawyer is intimately familiar with medical treatment and the
negotiations are being pursued against the backdrop of the overall resolution of
the case involved. If the lien is being disputed and the nature of the dispute is
beyond the area of the lawyer’s expertise, then the lawyer handling the
underlying matter may wish to refer the client to another lawyer with the requisite
expertise to handle that facet. For example, even a seasoned plaintiffs’ personal
injury counsel may not be familiar with the nuances of ERISA benefit plans and
related liens. Similarly, a lawyer served with a writ of garnishment stemming
from a wholly unrelated matter may neither have the requisite background nor
the inclination to become involved in challenging the garnishment.

Second, how should client confidential information be handled? In most
instances, the third-party claimant involved already knows that the lawyer is or
will be holding client funds. With a third-party claim related to the underlying
litigation, the lawyer may have already negotiated over the amount of the lien
with the holder. With an unrelated third-party claim, a lienholder may be aware
that the lawyer is holding funds due to the public notoriety of the matter leading to
the deposit of, for example, settlement funds. Therefore, the simple fact that a
lawyer is holding a particular client’s funds in trust is usually not an issue. By
contrast, if litigation follows, lawyers need to take appropriate precautions to
protect client confidential information in public court filings and related public
court proceedings. For example, a lawyer’s fee arrangements and related
confidential information may bear on what portion of settlement funds in trust
belong to the client, what portions are to be paid out for litigation costs and
expenses and what portion is due the lawyer in fees. Lawyers should use
appropriate procedural tools—such as protective orders, sealed filings or in camera proceedings—to preserve client confidential information.13

**Summing-Up**

A disputed third-party claim over client funds held in trust can put a lawyer
in a very uncomfortable position between the claimant and the lawyer’s client.
RPC 1.15-1(e) offers an avenue for judicial resolution that allows lawyers to
comply with their regulatory obligations without becoming an unwilling arbiter of
the dispute involved.

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1 RPC 1.15-1(b) permits a lawyer to maintain sufficient funds in a trust account to pay bank service charges—“but only in amounts necessary for those purposes.” See OSB Formal Op 2005-145 (prohibiting “cushions” in trust accounts that would otherwise defeat overdraft notification).

2 See OSB Formal Op 2005-149 (lawyer may wait a reasonable period of time after a client has been billed to withdraw the corresponding funds from an advance fee deposit held in trust).

3 Third-party funds can also be held in trust when, for example, a lawyer is handling a transaction and the law firm’s trust account is being used as the functional equivalent of an escrow. See OSB Formal Op 2005-55.

4 If a lawyer only receives notice of a claim after the lawyer has distributed the funds involved to the client, the lawyer is not required to restore the funds involved to the trust account. See OSB Formal Op 2005-149.


7 Respectively, Comment 4 to ABA Model Rule 1.15 and Section 45 to the Restatement.

8 Formal Opinion 2005-52 does not explore whether this creates a conflict under RPC 1.7(a)(2), which addresses, among others, conflicts between a lawyer’s duty to a third-party and the lawyer’s client.

9 See also OSB Formal Op 2005-68 at 2 (noting that in the event of a dispute over funds held in trust the lawyer must either retain the disputed portion in trust “or interplead the disputed funds”).


11 Particularly with a garnishment unrelated to the matter being handled, any work in the dispute beyond simply responding to the writ should be documented with a separate fee agreement because it is independent from the original matter for which the lawyer was retained. On a related note, a garnishment of an advance fee deposit does not ordinarily excuse the client from the client’s agreement with the lawyer to maintain an advance fee deposit.

12 Generally, the simple fact of representation is not privileged or otherwise confidential. See generally Laird C. Kirkpatrick, Oregon Evidence § 503.12[6] (6th ed 2013); RPC 1.0(f) (defining “information relating to the representation of a client” under the confidentiality rule, RPC 1.6).