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**Stuck in the Middle:
Disputed Funds Held in Trust**

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One of the most uncomfortable situations a law firm can face is a disputed third-party claim against funds held in the firm's trust account. Third-party claims can range from statutory liens connected to the case generating the funds to separate claims against the funds being held in trust that are not connected to the matter the firm handled for the client concerned. If the firm's client disputes the claims, the firm can quickly find itself "stuck in the middle" between its own client and the person asserting the claim.

The Oregon State Bar addressed both the duties involved and the potential remedies available to a law firm in Formal Opinion 2005-52 (rev 2016). Although necessarily general, Formal Opinion 2005-52 offers practical guidance for law firms. In this column, we'll survey both the duties and the remedies from the perspective of Formal Opinion 2005-52.

Before we do, three qualifiers are in order.

First, Formal Opinion 2005-52 does not address conflicts that may develop between a lawyer and a client if, for example, the lawyer determines that funds must be released to a statutory lienholder and the client insists otherwise. As a practical matter, this may lead to the lawyer's withdrawal.

Second, Formal Opinion 2005-52 also does not address the relatively common situation where a plaintiff's lawyer may attempt to negotiate a medical lien down as a part of settling a case for a client.

Finally, Formal Opinion 2005-52 focuses primarily on claims by third parties against funds held in trust. A lawyer may have a claim for fees against the funds as well.

Duties

Formal Opinion 2005-52 outlines two intertwined obligations.

First, Oregon RPC 1.15-1(d) requires a firm to disburse funds held in trust “that the client or third person is entitled to receive[.]” Formal Opinion 2005-52 notes that the phrase “entitled to receive” is not defined in the rule. Although the opinion cautions that the firm should not anoint itself the arbiter of disputed claims, the opinion finds that ordinarily secured creditors and statutory lienholders are “entitled to receive” funds over which they hold perfected secured or lien interests. By contrast, the opinion concludes that unsecured creditors do not automatically fall within the circle of claimants “entitled to receive” funds.

Second, Oregon RPC 1.15-1(e) counsels that if there is a dispute over entitlement to funds, the law firm must keep the funds “separate” “until the dispute is resolved.” This speaks to the fundamental duty reflected in the title to

RPC 1.15-1: “safekeeping property.” In other words, lawyers have a duty to preserve funds entrusted to them while competing claims to those funds are being resolved. Formal Opinion 2005-52 underscores that the duty of safekeeping is owed to all of those whose property the law firm is holding—whether clients or not.

Failing to follow RPC 1.15-1 can result in regulatory discipline, with, for example, *In re Goff*, 352 Or. 104, 105, 280 P.3d 984 (2012), finding that a lawyer violated RPC 1.15-1(e) for “mishandling disputed funds.” Courts have also cast the duty of safekeeping in fiduciary terms, with, for example, *Hetzel v. Parks*, 971 P.2d 115, 120 (Wash. App. 1999), finding that a lawyer failed to protect a nonclient’s funds held in the lawyer’s trust account. *In re Hockett*, 303 Or. 150, 155-160, 734 P.2d 877 (1987), discusses lawyer liability for assisting clients with fraudulent transfers and Formal Opinion 2005-52 cites *Hockett* for the proposition that lawyers owe the duty of safekeeping to all claimants of disputed funds pending resolution.

Remedies

In the event there is a non-frivolous dispute over “entitlement,” Formal Opinion 2005-52 counsels that any non-disputed portion must be disbursed

consistent with RPC 1.15-1(d) and that disputed funds must be held pending resolution of the dispute.

Again, Formal Opinion 2005-52 cautions that the law firm holding the disputed funds should not play the role of arbitrator over the dispute because its duty of safekeeping flows to all of the claimants pending resolution. Instead, Formal Opinion 2005-52 counsels that the firm should either hold the funds in trust while the claimants resolve their dispute or implead the funds for court resolution. Especially if the claim arises outside the context of the current case, impleading the funds may be the “safest” route for the law firm in many circumstances because the firm may not want to hold the funds in its own trust account for a long period and may lack the substantive expertise to assess “entitlement.”

If the claimant is already a party, then depositing the funds into the court handling the case involved is the simplest solution. UTCR 1.120 addresses disbursement of funds in Oregon state court and implicitly recognizes that funds may be deposited. 28 USC §§ 2041 and 2042 govern, respectively, deposit and withdrawal of funds in federal court. FRCP 67 and Oregon District LR 67-1 include supplemental information for federal court.

If the claimant is not a party, impleader is available in both state and federal court. ORCP 31 governs interpleader in Oregon state court. FRCP 22 and 28 USC § 1335 do the same in federal court. *Davis & Galm, LLC v. Neve*, 325 Or. App. 123, 528 P.3d 1165 (2023), recently discussed interpleader in the law firm context and merits close review for firms that finds themselves in this unusual situation.

ABOUT THE AUTHOR

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