

**THE PROFESSIONAL ETHICS COMMITTEE
FOR THE STATE BAR OF TEXAS
OPINION NO. 681**

September 2018

QUESTIONS PRESENTED

Under the Texas Disciplinary Rules of Professional Conduct, when does a third party have an interest in client funds sufficient to trigger a lawyer's duty to disburse or safeguard those funds for the third party's benefit? Does termination of the attorney-client relationship affect a lawyer's duty to safeguard or disburse client funds in which a third party claims an interest?

STATEMENT OF FACTS

As a result of the settlement of a client's personal injury lawsuit, settlement proceeds are deposited into a lawyer's trust account. The lawyer is aware of the following third-party claims:

- a) A claim by a hospital, which has a statutory lien against the settlement proceeds on account of medical services provided in connection with the client's injury.
- b) A claim by an insurer, which asserts a subrogation claim based on benefits provided to the client on account of the client's injury.
- c) A claim by a doctor, who provided medical services to the client after accepting a signed letter of protection that promised to pay for the services from the proceeds of the client's personal injury claim.
- d) A claim by a second doctor, who provided medical services to the client but did not receive either a letter of protection or an assignment of the proceeds of the client's personal injury claim.
- e) A claim by the client's former employer, who filed suit against the client for embezzlement and has made formal written demand that the lawyer refrain from disbursing any of the client funds pending resolution of the claim.

The lawyer discusses the third-party claims with the client. The client refuses to honor any of the third-party claims and instructs the lawyer to pay the client his entire share of settlement funds. The lawyer responds that the Texas Disciplinary Rules of Professional Conduct may prohibit disbursement of some or all of the funds to the client. The client then terminates the lawyer and again instructs the lawyer to pay the client's share of the settlement funds to the client, without deduction for any third-party claims.

DISCUSSION

Rule 1.14 of the Texas Disciplinary Rules of Professional Conduct addresses a lawyer's ethical obligations with regard to receiving, safeguarding and distributing funds or other property coming into the lawyer's possession. Comment 1 to Rule 1.14 notes that a lawyer who holds property belonging to another should do so with the care required of a professional fiduciary. The obligations in Rule 1.14 reflect that duty.

It is not uncommon for lawyers to encounter competing claims to funds recovered by the lawyer for the client, such as settlement proceeds. This opinion is intended to clarify a lawyer's obligations under the Rules when a lawyer is aware that a third-party claimant has an alleged interest in settlement proceeds or other client property held by the lawyer. For the sake of simplicity this opinion will refer to client "funds," even though the lawyer's obligations under Rule 1.14 also apply to non-monetary property.

Rule 1.14(a) sets forth a lawyer's duty to hold funds belonging in whole or in part to clients or third parties separate from the lawyer's funds:

"A lawyer shall hold funds and other property belonging in whole or in part to clients or third persons that are in a lawyer's possession in connection with a representation separate from the lawyer's own property. Such funds shall be kept in a separate account, designated as a "trust" or "escrow" account, maintained in the state where the lawyer's office is situated, or elsewhere with the consent of the client or third person. Other client 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."

Rule 1.14(b) describes a lawyer's obligation to notify the client or third-party interest holder when funds are received and to deliver and account for those funds:

"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."

Finally, Rule 1.14(c) describes a lawyer's duty when another person claims an interest in funds in a lawyer's possession:

"When in the course of representation a lawyer is in possession of funds or other property in which both the lawyer and other person claim interests, the property shall be kept separate by the lawyer until there is an accounting and severance of their interest. All funds in a trust or escrow account shall be disbursed only to those persons entitled to receive them by virtue of the representation or by law. If a

dispute arises concerning their respective interests, the portion in dispute shall be kept separated by the lawyer until the dispute is resolved, and the undisputed portion shall be distributed appropriately.”

With respect to a lawyer’s duty to withhold funds in the event of a dispute, Comment 3 to Rule 1.14 provides:

“Third parties, such as 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.”

Rule 1.14 does not define when a third party has an “interest” in client funds sufficient to trigger a lawyer’s duties regarding third-party claims. Lawyers faced with a third-party claim to client funds may find themselves in an ethical quandary, uncertain as to whether a third party has an interest in the client funds sufficient to require the lawyer to refrain from disbursing funds to the client. The dilemma may be compounded when the client affirmatively instructs the lawyer not to distribute or even reveal the existence of the funds to the third party.

The Committee concludes that a Texas lawyer should be guided by the following considerations in determining how to proceed in response to a third party’s claim regarding client funds.

1. With regard to client funds, a lawyer’s primary duty is to the client. Unless a lawyer is aware that a third-party claimant has an “interest” in client funds held by a lawyer, the lawyer must deliver client funds to the client in accordance with Rule 1.14. *See* Professional Ethics Committee Opinion 606 (May 2011) (lawyer may not refuse to disburse funds to client based on lawyer’s mere belief, in the absence of an asserted claim, that client may have improperly or illegally obtained the funds).
2. For purposes of Rule 1.14, a third-party claimant has an “interest” in client funds held by a lawyer only when the third party has a matured legal or equitable interest in those particular funds.
3. A matured legal or equitable interest in particular client funds exists when the interest is based on:
 - a. A statutory lien,
 - b. A judgment that adjudicates ownership or disposition of the funds in question,
 - c. A court order regarding the funds in question,
 - d. A written assignment conveying an interest in the funds in question,
 - e. A right of subrogation regarding the funds in question. or
 - f. A signed letter of protection or similar agreement formed to aid the lawyer in obtaining the funds in question, which promises payment upon collection.

4. A mere general creditor of the client does not have an “interest” in client funds that requires the lawyer to safeguard funds for the benefit of the creditor or allows the lawyer to refuse to disburse funds to the client. The special protection provided to third-party creditors under Rule 1.14 is not implicated simply because the third party provided services to the client or expects that it will be paid from the client’s recovery. A general judgment against the client for money damages does not constitute an interest in client funds.
5. When a lawyer is aware that a third-party claimant has an interest in client funds and the third party’s claim is undisputed, the lawyer should deliver the funds to the third party promptly in accordance with the interest and applicable law, and deliver the balance to the client.
6. If a client disputes the validity or amount of a third-party interest-holder’s claim, the lawyer should notify the interest-holder. The lawyer should promptly distribute the undisputed portion of the client funds and retain the disputed portion of the funds in trust until the dispute is resolved. If the dispute is not resolved within a reasonable time, the lawyer may opt to file an interpleader action and deposit the disputed funds with a court.
7. A lawyer may not “unilaterally assume to arbitrate a dispute between the client and the third party,” Rule 1.14, Comment 3. However, a lawyer may “suggest a means for prompt resolution of the dispute, such as arbitration.” Opinion 625 (February 2013).
8. If a lawyer is obligated under Rule 1.14 to withhold client funds due to the claim of a third party who has a matured legal or equitable interest in the funds, the lawyer’s obligation to the third party survives and is unaffected by the client’s termination of the lawyer-client relationship. The obligation arises from the lawyer’s duty to respect the property rights of others, not from the attorney-client contract.

In reaching these conclusions the Committee has considered numerous opinions of professional ethics committees from other jurisdictions, each interpreting a rule closely similar to Rule 1.14. Although the opinions vary in some respects, they uniformly recognize that a lawyer’s duty to withhold client funds from a client arises only in response to a claim based on a matured legal or equitable interest such as those enumerated above. *See, e.g.*, Alaska Bar Ass’n Ethics Comm., Op. 92–3 (1992); Ariz. Comm. on Rules of Prof’l Conduct, Formal Op. 98–06 (1998); Colo. Bar Ass’n Ethics Comm., Op. 94 (1993); Conn. Comm. on Prof’l Ethics, Informal Ops. 02–04 (2002), 01–08 (2001) and 95–20 (1995); D.C. Bar Legal Ethics Comm., Op. 293 (2000); N.H. Bar Ass’n Ethics Comm., Formal Op. 1998–99/3 (1999); S.C. Bar Ethics Advisory Comm., Ops. 05–08 (2005), 94–20 (1994), 93–31 (1994) and 93–14 (1993); Utah Ethics Advisory Op. Comm., Op. 00–04 (2000); Va. Standing Comm. on Legal Ethics, Ops. 1865 (2012) and 1747 (2000); Wisc. State Bar Prof’l Ethics Comm., Formal Op. E-09-01 (2009); *see also* Vincent R. Johnson, *The Limited Duties of Lawyers to Protect the Funds and Property of Nonclients*, 8 St. Mary’s Journal on Legal Malpractice & Ethics No.1, Article 2, 58 (2018); Charles M. Cork III, *A Lawyer’s Ethical*

Obligations When the Client's Creditors Claim a Share of the Tort Settlement Proceeds, 39 Tort Trial & Ins. Prac. L.J. 121 (2003).

Application of the foregoing principles to the third-party claims described in the Statement of Facts leads to the following conclusions:

- a) The hospital has an interest in the client funds due to its statutory lien.
- b) The insurer has an interest in the client funds due to its right of subrogation.
- c) The first doctor has an interest in the client funds due to the letter of protection.
- d) The second doctor does not have an interest in the client funds because the doctor did not provide the services pursuant to a letter of protection or assignment.
- e) The former employer is no more than a potential general creditor and therefore does not have an interest in the client funds.
- f) The lawyer must pay the hospital, insurer and first doctor from the client funds in accordance with their interests and applicable law, unless the client disputes the validity or amount of the claims. In the event of a dispute the lawyer must retain the disputed amount in trust until the dispute is resolved or the funds are deposited with a court in an interpleader proceeding.
- g) Because the second doctor and the former employer do not have an interest in the client funds, the lawyer must honor the client's instructions not to pay those parties' claims and may not withhold client funds from the client on account of those claims.
- h) The client's termination of the lawyer does not affect the lawyer's obligation to retain client funds sufficient to pay the claims of the hospital, insurer and first doctor. The lawyer must continue to refuse to transfer the withheld funds to the client.

Nothing in this opinion should be construed as altering a lawyer's obligation of truthfulness in statements to third persons (Rule 4.01) or a lawyer's obligation not to engage in conduct involving dishonesty, fraud, deceit or misrepresentation (Rule 8.04(a)(3)). Further, this opinion pertains only to a lawyer's obligations under the Texas Disciplinary Rules of Professional Conduct. A lawyer's civil liability to a client or the client's creditors involves questions of law beyond the jurisdiction of the Committee.

CONCLUSION

Under the Texas Disciplinary Rules of Professional Conduct, if a lawyer is aware that a third-party claimant has an interest in client funds in the lawyer's possession, the lawyer must pay the funds to the third party unless the claim is disputed by the client, in which case the lawyer must withhold the disputed portion from both the client and the third party until the dispute is resolved

or the lawyer has interpleaded the disputed funds. For purposes of Rule 1.14 of the Texas Disciplinary Rules of Professional Conduct, a third-party claimant has an “interest” in client funds held by a lawyer only when the third party has a matured legal or equitable interest in those particular funds. A matured legal or equitable interest in particular client funds exists when the interest is based on:

- a. A statutory lien,
- b. A judgment that adjudicates ownership or disposition of the funds in question,
- c. A court order regarding the funds in question,
- d. A written assignment conveying an interest in the funds in question,
- e. A right of subrogation regarding the funds in question, or
- f. A signed letter of protection or similar agreement formed to aid the lawyer in obtaining the funds in question, which promises payment upon collection.

If a lawyer is obligated under Rule 1.14 to withhold client funds from the client due to the claim of a third party who has a matured legal or equitable interest in the funds, the lawyer’s obligation to the third party survives and is unaffected by the client’s termination of the lawyer-client relationship.