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ETHICALLY COMPLICATED DISBURSEMENTS

New Ohio Rules of Professional Conduct Add Ethical Duties toward Third Parties

I. INTRODUCTION

After a hard won judgment or settlement, a complicated disbursement process is the last thing an attorney needs. He must deal with a host of bills and claims as well as his client's requests. For the unprepared attorney, this process is a minefield of trouble. Without diligent preparation and research, an attorney could miss a valid assignment or fail to recognize subrogation interests. Resurrecting a case due to those problems is a nightmare, but it's not the attorney's worst. Now, there are ethical considerations.

On February 1, 2007 the Supreme Court of Ohio officially adopted the new Ohio Rules of Professional Conduct. Based on the ABA Model Rules of Professional Conduct, these new rules brought Ohio ethics in line with a large number of other states that had already discarded the old code. The rules bring new concerns for attorneys during the disbursement process.[1] In particular, Rule 1.15(d) recognizes an attorney's ethical duty towards a third party who has an interest in the case proceeds.[2] The text of the rule is as follows:

> (d) 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 or a third person, confirmed in writing, a lawyer shall promptly deliver to the client of third person any funds or property that the client or third person is entitled to receive. Upon request by the client or third person, the lawyer shall promptly render a full accounting regarding such funds or other property.[3]

The invocation of this rule will generally arise in personal injury cases.[4] After a judgment or settlement, the plaintiff's attorney places the funds in his trust account. However, the funds might be burdened by the interest of a third party, generally an entity with a subrogation lien or someone to whom the plaintiff has given an assignment. Complicating matters, the client will sometimes direct the attorney not to pay the creditors.

The new Ohio rules attempt to delineate an attorney's ethical obligations in this situation. When in possession of funds for disbursement, Rule 1.15(d) places three ethical obligations on the attorney: (1) promptly notify the client and any third person of the receipt of the funds; (2) promptly deliver to the client or third person any funds that the client or third person is entitled to receive; and (3) upon request by the client or third person, to promptly render a full accounting regarding the funds.[5] Beyond this, an attorney has new ethical obligations under Rule 1.15(e) when a dispute as to the funds arises.[6]

These new ethical duties raise a series of questions as to how Ohio will interpret and enforce the rules. Other states, having already adopted practically identical rules, can be looked to for some guidance. Caselaw interpreting the old Ohio Code of Professional Responsibility can help as well. However, there are no definitive answers yet, and any practicing attorney must double his efforts to ensure that he is within the bounds of the new ethical rules. Without clear precedents, we attempt to dissect what constitutes an interest, what the attorney's duty of third party notification is, and what an attorney should do in the case of a dispute.

II. WHAT CONSTITUTES AN "INTEREST"

The threshold issue in determining the applicability of Rule 1.15(d) to a third party is whether that party has an "interest" in the funds.[7] The rule itself does not give clear guidance as to what constitutes a valid interest. That determination is left for substantive law to decide.[8] However, other jurisdiction have noted that the rule does make clear that a mere "claim" will not suffice; the phrase used in the rule is "has an interest," not "claims an interest."[9] Also noted in Comment four (4) to the rule, the attorney only has to recognize the interest when it "is not frivolous under applicable law."[10]

This rule is not just about

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medical payments and settlements. It is really about money coming in that is due to someone else. Other jurisdictions (not Ohio) have noted that a general unsecured obligation might not amount to an interest under this ethical rule.[11] For instance, the "attorney is not obligated to pay…the client's dry cleaning bill or credit card debts even if on notice thereof.[12] Rather, only a "matured legal or equitable claim" constitutes a valid interest.[13] Other jurisdictions have also provided that legal interests include: (1) judgment liens, (2) statutory liens, (3) assignments, and (4) letters of protection. [14] It is recommended that the attorney should also investigate for common law and statutory assignments, garnishments, attorney's liens, medical liens and subrogation interests.[15]

In addition, even though it might be argued that ordinary medical bills used in your demand package in settling a personal injury claim might not give rise to the status of a legal interest, a disciplinary governing board might construe such bills like it would an assignment or lien. As such, the careful lawyer should probably consider the ordinary related medical bill as an "interest" until the governing ethical board defines in more detail the definition of an "interest."

Of particular importance to an attorney are any assignments that the client signed.[16] "An assignment is a transfer to another of all or part of one's property in exchange for valuable consideration."[17] In the typical personal injury case, an assignment is used to ensure that the medical provider will be paid for its efforts out of any damage award the plaintiff wins.[18] When the attorney knows of such an assignment, he is obligated to pay the assignee; under the laws of assignments, the money no longer belongs to the client.[19]

Attorneys should also beware that their promises to medical providers for payment may amount to giving the provider an interest in the funds.[20] A frequent practice is for attorneys to send a letter to the medical provider promising payment in return for the provider's continued care for the client.[21] Attorneys need to be careful when writing these "letters of protection." In technical terms, a letter of protection is not a real assignment.[22] However, with regards to the new ethical rules, the letter of protection could be seen as an acknowledgement of a third party's financial interest, obligating lawyers to pay the companies out of case proceeds.[23]

Discovering what third party interests exist in a case is a difficult task on its own; attorneys can often be faced with uncertainty as to the client's financial outlook. Medical providers and other lien holders are generally good about sending bills. However, if the client loses the bill or, worse, discards it purposefully, the attorney will be in the dark. It is not clear whether under Ohio law an attorney will only be responsible for those interests of which he has actual knowledge, whether constructive knowledge suffices or whether the attorney must seek out potential third party interests. The Ohio caselaw on assignments may be telling: the Ohio Supreme Court has held that "once the account debtor has received reasonable notice of the assignment," it must make payments to the assignee.[24] Other states require actual knowledge of the interest.[25] Regardless, lawyers must know to ask the right questions to obtain the full financial picture of the case.

III. THIRD PARTY NOTIFICATION

One of the key changes brought by the new rules is the additional duty of the attorney, when he receives funds for disbursement, to notify a third party who has an interest that the funds have arrived.[26] No longer can an attorney receive the money in trust without telling the third party and continue to negotiate the payments until he reaches a satisfactory agreement. Rule 1.15(d) requires an attorney to notify the third party promptly. This new ethical consideration constrains the negotiation tactics that many attorneys use because the third party knows the funds exist and are in counsel's hands. As such, bill reductions may be less likely.

Here, it is critical that the attorney has done his research. If the creditor has an interest in the funds, the client's attorney is ethically obligated to notify the claimant.[27] As such, the attorney needs to know of all interests. Other states have found that the attorney does not need to intend to withhold the information about the receipt of funds.[28] Rather, in those states, if an attorney even mistakenly fails to deliver notification he has violated the new ethics rules.[29]

IV. PROMPT DELIVERY AND THIRD PARTY ACCOUNTING

After notification, the attorney has a duty to promptly deliver the funds to the third party.[30] There is no bright-line definition for "promptly deliver," but other states have made clear that time limits exist.[31] In one Rhode Island case, an attorney who waited eleven months to notify the third party and deliver the funds was deemed to have violated that state's version of 1.15(d).[32]

It is likely that an attorney can continue with reasonable negotiations once the funds are in-hand. This is suggested by the text of the rule: "[e]xcept as stated in this rule or *otherwise permitted by law or by agreement with the client or a third person*…a lawyer shall promptly deliver to the client of third person any funds…" (emphasis added). However, if the third party does not wish to negotiate and truly owns a valid interest, the attorney is playing with ethical fire if he delays too long.

Complicating matters is the new provision allowing for a third party to request an accounting of the funds.[33] The attorney now has

an ethical obligation not only to notify the third party of the receipt of funds, but, upon request of the third party, the attorney must also render an accounting.[34] When a third party knows of the funds, the attorney's ability to negotiate with a third party for a legitimate reduction may indeed be compromised.

V. DISPUTE

Under the new scheme, "a lawyer may have a duty under applicable law to protect…third-party claims against wrongful interference by the client."[35] Thus, when a client instructs the attorney not to pay known creditors with valid interests, the attorney must refuse to surrender the money to either party until the dispute is resolved.[36] To do this, the attorney will invoke the new rule 1.15(e):

> (e) 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.[37]

The comments to rule 1.15(e) make it clear that the attorney should not unilaterally assume to arbitrate the dispute between the client and the third party.[38] The attorney may mediate; however, should that fail, the lawyer may have to file an action to have a court resolve the dispute.[39] It is unclear what the attorney's role in that trial will be; with an ethical obligation to both the client and the third party, problems with conflict of interest are readily apparent.

It should be noted that if the attorney himself claims an interest in the funds, an action to resolve the dispute should be filed immediately.[40] If the attorney fees are not in dispute, the attorney will likely have priority over other creditors when collecting his share of the payment.[41] Ohio courts have employed equitable considerations to "uphold the priority of attorneys' liens over the liens of competing competitors."[42]

VII. IMPLICATIONS FOR COUNSEL

Attorneys need to be aware that lack of due diligence in a disbursement process can lead not only to a legal obligation to the third party, but also to an ethical violation. Should the attorney wrongfully turn the money over to his client, he may be liable for conversion of the wrongfully paid funds.[43] Further, under the new scheme, the third party may file an ethical complaint against the attorney; the consequences that go along with such a complaint might extend far beyond a financial burden. Until Ohio law is fully developed in this new ethical area, attorneys should be conservative in their disbursement approach. It is recommended that the attorney err on the side of caution and notify all pertinent interest before disbursements of monies.

VII. CONCLUSION

There is much uncharted territory with the new Ohio Rules of Professional Responsibility. The old code had nothing comparable to the new Rules 1.15(d) and (e). As such, attorneys would be wise to approach case disbursement processes with caution. Lawyers should look for potential third party interests, diligently notify them of the receipt of funds, respond to all requests for accounting, and most importantly, do it all in writing. Due diligence and responsibility will easily save attorneys the time and hassle of ethical complaints. No one wants to deal with an ethical complaint at the end of a case. However, under the new rules, the unprepared attorney could have significant legal issues with both the third party, and more importantly, ethical and disciplinary governing boards.

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[1] *See* Prof. Cond. Rule 1.15, Comparison to former Ohio Code of Professional Responsibility ("There are no Disciplinary Rules comparable to Rules 1.15(d), (e), (f), and (g)").
[2] Prof. Cond. Rule 1.15(d).
[3] *Id.*
[4] *See* Prof. Cond. Rule 1.15 Comment [4] ("Division (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*." [emphasis added]).
[5] Prof. Cond. Rule 1.15(d).
[6] Prof. Cond. Rule 1.15(e).
[7] Prof. Cond. Rule 1.15(d) ("Upon receiving funds or other property in which a client or third person *has an interest*…" [emphasis added]).
[8] *See Silver v. Statewide grievance Committee* (1996), 697 A.2d 392 (Conn.).
[9] Prof. Cond. Rule 1.15(d). *See* D.C. Bar Opinion 293, quoting D.C. R. Prof. Conduct 1.15, comment [4] (stating "The third party must have a 'just claim' as to which 'applicable law' imposes a duty on the lawyer to distribute the funds to the third party or withhold distribution").
[10] Prof. Cond. Rule 1.15 Comment [4].
[11] *See* D.C. Bar Opinion 293 (stating "In general, a 'just claim' that the lawyer must honor pursuant to Rule 1.15 is one that relates to the particular funds in the lawyer's possession, as opposed to merely being (or alleged to be) a general unsecured obligation of the client."). *See also* CT. Eth. Op. 95-20, 1995 WL 389639 (Conn.Bar.Assn.) (stating "The U.S. Supreme Court has held that significant procedural safeguards are required before 'a state statute enable[es] an individual to deprive another of his or her property by means of the prejudgment attachment or similar procedure'…[Rule 1.15] cannot be interpreted to require the lawyer to effect an unconstitutional deprivation of the client's property…without any provision for a judicial determination of the claimed 'interest'").
[12] *Farmer Ins. Exch. V. Zerin* (1997), 53 Cal. App. 4th 445, 459.
[13] UT Eth. Op. 00-04, 2000 WL 815564 (Utah St.Bar.); *See also* D.C. Bar Opinion 293; CT Eth. Op. 95-20.
[14] *Id.*
[15] *See Ladenheim v. Klein* (2000), 749 A.2d 387 (NJ); *Hotel Employees v. Getner* (1993), 815 F.Supp. 1354 (Nev.).
[16] *See First Bank of Marietta v. Roslovic & Partners, Inc.* (1999), 86 Ohio St.3d 116, 118, 1999-Ohio-89 for a definition of what constitutes a valid assignment.
[17] *Roselawn Chiropractic Center v. Allstate Insurance Co.* (2005), 160 Ohio App.3d 297, 299, 2005-Ohio-1327.
[18] *Id.*
[19] *See Id. See also Hsu v. Parker* (1996), 116 Ohio App.3d 629, 688 N.E.2d 1099; *Achrem v. Expressway Plaza Limited* (1996), 112 Nev. 737, 917 P.2d 447 (Nev.).
[20] *In the Matter of Moore* (2000), 4 P.3d 664 (NM); *In the Matter of Norman* (1999), 708 N.E.2d 867 (Ind.); *the Florida Bar v. Silver*

(2001), 788 So.2d 958 (Fla.); *In the Matter of Kirby* (2002), 766 N.E.2d 351 (Ind.). (hereinafter "Letter of Protection Cases").

[21] *Id.*

[22] *See First Bank of Marietta, supra* note 13.

[23] *See* Letter of Protection Cases, *supra* note 15.

[24] *See First Bank of Marietta, supra* note 13.

[25] *See* D.C. Bar Opinion No. 293 (1999); Conn. Bar Ethics Opinion 95-20 (1995); Utah Bar Ethics Opinion No. 00-04 (2000).

[26] Prof. Cond. Rule 1.15(d).

[27] *Id.*

[28] *See Attorney Grievance Comm.n v. Glenn* (1996), 341 Md. 448; *Attorney Grievance Comm'n v. Webster* (1998), 348 Md. 662.

[29] *Id.*

[30] Prof. Cond. Rule 1.15(d)

[31] *See In re Ross* (1995), 658 A.2d 209 (D.C. App.)

[32] *Id.*

[33] Prof. Cond. Rule 1.15(d).

[34] *Id.*

[35] Prof. Cond. Rule 1.15 Comment [4].

[36] *Id.*

[37] Prof. Cond. Rule 1.15(e).

[38] Prof. Cond. Rule 1.15 Comment [4].

[39] *Id.*

[40] *See* Michigan Informal Ethics Opinion RI-61 ("…a lawyer could not unilaterally mediate the dispute between a lawyer, client and third parties who all claimed interest in funds in a client trust account but rather must begin proceedings immediately to resolve the dispute."

[41] *Cohen v. Goldberger* (1923), 109 Ohio St. 22; *See also* In re Simms Construction Services Co., Inc. v. Decker (2004), 311 B.R. 479. (hereinafter "Simms").

[42] 34 A.L.R.4th 665; *See also* Simms, *supra*, quoting *Cohen* (stating "…the lower court found in favor of the attorneys. The Supreme Court affirmed…[explaining] that recognizing the creditor's claim as superior to that of the attorneys'…'[leaves] without remuneration of any sort the attorneys but for whose efforts, presumably, the fund would not have been procured…'").

[43] *Dickey v. Burick* (2005), 161 Ohio App.3d 224, 2005-Ohio-2601.