New Tool Addresses Third-Party Claims to Client Funds

BY GEOFF TRACHTENBERG & PATRICIA SALLEN

It's a story that many lawyers know. Your personal injury case has finally settled, and the money is in your trust account to be disbursed. The client, who has been anxiously awaiting the settlement, needs their portion of the proceeds—*yesterday*. They have bills to pay, mouths to feed, and they want to move on with their lives.

But before disbursement takes place, a putative creditor chimes in and claims an interest in the money. To make matters more complicated, this creditor's claim is, in whole or in part, illegitimate or unenforceable for some reason.

Personal injury lawyers know that this is a common problem.

Meanwhile, the client is calling—repeatedly—to tell you to ignore the putative creditor and hand over the money. After all, they remind you, it is their money.

But you cannot get the putative creditor to acknowledge that their claim is illegitimate or unenforceable. Or, as is unfortunately the case, perhaps they are simply making the illegitimate or unenforceable claim knowingly in order to demand a nuisance payment to "go away."

To comply with your client's direction, however, you would have to conclude that the putative creditor doesn't have a "matured legal or equitable claim." This is frequently not possible and exposes the lawyer to being second-guessed at a later ethical inquiry if the decision is incorrect.

So there you are, stuck in the middle between your client, to whom you owe all attorney–client duties, and the putative creditor, for whom you are required to safeguard the funds—*if* you are unwilling to decide that the putative creditor does not have a "matured legal or equitable claim" to the settlement funds.

The proverbial rock and a hard place.

What are your traditional options?

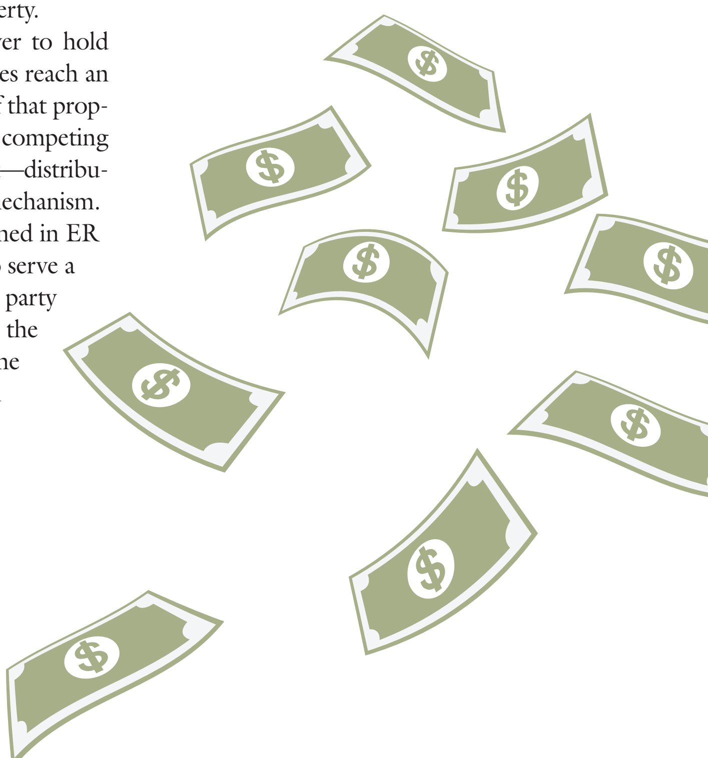
- Assess the putative creditor's claim and make the determination as to whether the creditor has a matured legal or equitable claim. If you call it wrong, you have an angry client or angry putative creditor, either of whom may file a bar complaint.
- File an interpleader or declaratory relief action, which requires you to file a claim *against* your client and/or *against* your client's interests.
- Agree, with the client's consent, to pay the putative creditor to "go away."

Effective January 1, 2014, you have another tool.

The Arizona Supreme Court has given lawyers a whole new mechanism—unique among jurisdictions—for dealing with third-party claims to client property.

ER 1.15 now directs a lawyer to hold disputed property until the parties reach an agreement on the distribution of that property; a court order resolves the competing claims; or—this is the new part—distribution is allowed under the new mechanism.

That new mechanism is outlined in ER 1.15(f), which allows a lawyer to serve a written notice upon the third party that the lawyer will distribute the property to the client "unless the third party initiates legal action and provides the lawyer with written notice of such action within 90 calendar days." If the third party does not provide timely written notice of a legal action and, assuming disbursement



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is not prohibited by law or court order, the lawyer may ethically disburse the property to the client.

The new mechanism came about as the result of a rule-change petition Geoff Trachtenberg, David Abney and Thomas Ryan filed that sought to resolve the impossible position—between client and third party—that many lawyers found themselves having to address. It is particularly apropos where a third-party makes an illegitimate or unenforceable claim to client proceeds.

Why This Is a Big Deal

- *First*, it means that lawyers do not ethically have to make the legal determination as to whether the third party has a "matured legal or equitable claim." That's a standard that is not easy to define. In fact, it appears to have originated by way of a passing reference in an ethics treatise and has never been clearly defined.
- *Second*, it means that lawyers' hands are not tied in situations where a third party is improperly demanding proceeds but is unwilling to take any action to prosecute its claim (likely because they know the claim is meritless).
- *And third*, it means that lawyers need not go to the expense of filing suit against the third parties over claims that are unmeritorious only to have the third parties drop the claim or default in the action—things that further diminish client funds and delay distribution.

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When could you send the ER 1.15(f) notice? Any time there is a lien, subrogation or other third-party claim. The mechanism could be used with claims that you previously have acknowledged or other claimed interests of which you have become aware. The mechanism can be used where there is or might be a "matured legal or equitable claim" without having to make such a determination.

When should you send the ER 1.15(f) notice? Any time you identify a third-party claim against your client's proceeds that you believe, in whole or in part, is illegitimate or unenforceable for any reason. Or any time you believe a third-party claim is not a "matured legal or equitable claim."

What else should you know about ER 1.15(f) notices?

- *First*, this is a change to an *ethical* rule. ER 1.15(f) only provides a mechanism to allow lawyers to avoid ethical complaints. Using the mechanism will not protect you if you have a *legal* obligation to hold the property. ER 1.15(f)(4) ("Nothing in this rule is intended to alter a third party's substantive rights").
- *Second*, if the disbursement is prohibited by law or court order, then even if you send the ER 1.15(f) notice, you cannot ethically disburse the money to your client. ER 1.15(f)(2) ("If the lawyer does not receive such written notice from the third party within the 90-day period, and provided that the disbursement is not prohibited by law or court order, the lawyer may distribute …").
- *And third*, although the rule does not require you to make a written determination that a claim is illegitimate, unenforceable or is otherwise not a matured legal or equitable claim, you should not use the mechanism to intentionally avoid paying legitimate claims. Intentional abuse of ER 1.15(f) notices could lead to violations of other ethical rules.

The Arizona Supreme Court has given lawyers a whole new mechanism—unique among jurisdictions.

What should the ER 1.15(f) notice look like?

- *First*, track the rule itself. ER 1.15(f)(1) directs that the notice must inform the third party that the lawyer "may distribute the property to the client unless the third party initiates legal action and provides the lawyer with written notice of such action within 90 calendar days of the date of service of the lawyer's notice." ER 1.15(f)(3) directs that if the lawyer is notified as required, the lawyer must continue to hold the property separate unless the parties reach an agreement on distribution or a court resolves the matter.
- *And second*, a new comment to the rule outlines what should be included at a minimum:

> Although there is no one form of notice that will be acceptable, the notice should generally include at least the following: (a) a *description* of the funds or property in the lawyer's possession; (b) the *name* of the client claiming an interest in the funds and other information reasonably available to the lawyer that would allow the third person to identify the claim or interest; (c) *a mailing address, telephone number, and email address* where the third party can provide notice to the lawyer of the commencement of an action asserting an interest in the funds or property; and (d) the *proposed distribution* of the funds or property. The notice shall be served in the manner provided under Rules 4.1 or 4.2 of the Arizona Rules of Civil Procedure.

(Emphasis added.)

Conclusion

The new ER 1.15(f) is intended to extricate the lawyer from between the proverbial rock and a hard place by shifting the burden to file lawsuits over these disputes from the clients and their lawyers to the third parties claiming rights to money. In short, lawyers will be able to ethically tell third parties to act or else the money will be disbursed to the client. AZAT