

**STATE BAR OF NEVADA**

**STANDING COMMITTEE ON ETHICS AND PROFESSIONAL RESPONSIBILITY**

**Formal Opinion No. 31<sup>1/</sup>**

March 25, 2005

**BACKGROUND**

The question below typically arises in the context of a personal injury suit. The plaintiff's attorney has settled with the tortfeasor and has client funds in the trust account. The attorney is ready to disburse the trust account funds to the client, but a third party claims an entitlement to payment as a creditor of the client. The claimant is frequently a person who claims a "lien" entitling the creditor to reimbursement from the plaintiff's personal injury recovery after having supplied or paid for medical care for the injured plaintiff. To complicate the question, the client sometimes expressly instructs the lawyer holding the funds not to pay the creditor.

**QUESTIONS:**

1. Generally, what are the ethical duties of a lawyer who is making payment to the client (and the disbursing lawyer under a fee agreement) when the lawyer has knowledge that a third party creditor has a claim or lien against the funds to be disbursed?
2. Specifically, is the lawyer ethically obligated to follow the client's instructions, ignore the third party claim, and disburse all of the funds to the client?

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<sup>1</sup> Not citeable as authority. SCR 123.

## ANSWER

Under SCR 165<sup>2/</sup> if the third person has<sup>3</sup> an “interest” in the funds, the lawyer has three ethical obligations with respect to the funds: (1) to promptly notify the client and third person on receipt of the funds; (2) to 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.<sup>4/</sup> As a result, this is a rare circumstance in which the lawyer has ethical duties running in favor of someone other than the lawyer’s client! Furthermore, the lawyer may have these ethical obligations even though the client has instructed the lawyer to the contrary!

## AUTHORITIES RELIED ON

Nevada Supreme Court Rule 165 (Safekeeping Property);  
Restatement of the Law Governing Lawyers §§44(2) and 45(1);  
Silver v. Statewide Grievance Committee, 679 A.2d 392 (Conn. 1996);  
D. C. Bar Opinion 293 (1999);  
Conn. Bar Ethics Opinion 95-20;  
Utah Bar Ethics Opinion 00-04 (2000);  
Achrem v. Expressway Plaza Limited, 112 Nev. 737, 917 P.2d 447 (1996);  
In the Matter of Hodge, 676 A.2d 1362 (RI 1996);  
Ladenheim v. Klein, 749 A.2d 387 (NJ 2000);  
Bonanza Motors, Inc. v. Webb, 567 P.2d 1102 (ID 1983);  
Brinkman v. Moskowitz, 238 N.Y.S. 2d 876 (1962);  
HSU v. Parker, 688 N.E.2d 1099 (OH 1996);  
Herzog v. Irace, 594 A.2d 1106 (ME 1991);  
In the Matter of Moore, 4 P.3d 664 (NM 2000);

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<sup>2</sup> Taken from ABA Model Rule of Professional Conduct 1.15 (Safekeeping Property).

<sup>3</sup> As opposed to “claims” an interest.

<sup>4</sup> *See also*, Restatement of the Law Governing Lawyers §§44(2) and 45(1).

In the Matter of Norman, 708 N.E.2d 867 (Ind. 1999);  
The Florida Bar v. Silver, 788 So.2d 958 (Fla. 2001);  
In the Matter of Kirby, 766 NE2d 351 (Ind. 2002);  
Hotel Employees v. Gentner, 815 F.Supp. 1354 (D.Nev. 1993);  
In re Ross, 658 A.2d 209 (D.C. App. 1995);  
Gumm v. Mainor, 118 Nev. 912, 59 P.3d 1220 (2002);  
Michel v. Eighth Judicial District Court, 117 Nev. 145, 17 P.3d 1003 (2001); and  
NRS 108.590 et seq.;

### DISCUSSION

The determinative issue in applying SCR 165 is when does a third party “have” an “interest” in funds possessed by a lawyer?

SCR 165 itself does not create third party interests in funds; it just requires the attorney possessing the funds to honor the interests that the law recognizes. Silver v. Statewide Grievance Committee, 679 A.2d 392 (Conn. 1996). Therefore, this Opinion does not attempt list and define all of the claims that rise to the level of an “interest” in trust funds. That is a matter of substantive law. Rather, this Opinion gives examples of some of the types of claims that have been held to be “interests” – in the context of the ethical obligation – and some that have not.

First, the mere assertion of a “claim” by a general, unsecured creditor is not an “interest” in the funds themselves in the hands of the lawyer. Significantly, SCR 165 uses the terms “has” an interest rather than has a “claim” or “claims an interest”. D. C. Bar Opinion 293 (1999). Indeed, as the D.C. Bar Opinion points out, the freezing of client funds for mere “claims” would, in effect, be an unlawful pre-judgment attachment raising possible Due Process issues. Rather, to rise to the level of an “interest”, the claim must relate to the particular funds in the lawyer’s trust account. See, D.C. Bar Opinion 293; Conn. Bar Ethics Opinion 95-20; and Utah Bar Ethics Opinion 00-04 (2000).

The most clear-cut example of when the law will recognize an interest in funds is when the third party receives a common law assignment of such funds. This classic type of interest has recently been enforced by the Nevada Supreme Court in Achrem v. Expressway Plaza Limited, 112 Nev. 737, 917 P.2d 447 (1996). In Achrem, the personal injury plaintiff’s attorney paid out the settlement proceeds in spite of the attorney’s knowledge that the plaintiff had assigned part of the recovery to a

commercial creditor. The assignee sued the attorney personally for the amount of the assignment. The attorney defended on the basis that the attorney had a fiduciary duty as the assignor's attorney to pay the settlement funds to the assignor/client, since the client gave the attorney express instructions to not make payment to the assignee. The District Court held – and the Nevada Supreme Court agreed – that the attorney was not obligated to pay the assigned funds to the client, because, under the law of assignments, the funds no longer belonged to the client. Thus, the client had no “interest” in the assigned funds; rather, the assignee had the entire “interest” in the assigned funds and the attorney was obligated<sup>5/</sup> to pay the funds to the assignee to the extent of the assignment. The holding is entirely consistent with the mandates of SCR 165<sup>6/</sup>, but since the case was not an attorney discipline case, the Rule was not cited by the Court. Similarly, See Bonanza Motors, Inc. v. Webb, 567 P.2d 1102 (ID 1983) and Herzog v. Irace, 594 A.2d 1106 (ME 1991).

Of course, there is no doubt that the law would recognize as an “interest”: an attachment or garnishment upon the specific funds, a statutory attorney's lien, and a court order relating to the specific funds.

In addition, a medical provider may have an “interest” in the funds when there has been no formal assignment of the funds to the medical provider. Thus, when the plaintiff's attorney sends a letter to a medical provider promising payment from any recovery to induce the provider to treat the plaintiff, such “letter of protection” will

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<sup>5</sup> In addition to the attorney's violation of an ethical Rule by not paying the third party creditor with an interest in the funds, the attorney may be personally liable for conversion of the wrongly paid funds. Achrem; In the Matter of Hodge, 676 A.2d 1362 (RI 1996); Ladenheim v. Klein, 749 A.2d 387 (NJ 2000); Bonanza Motors, Inc. v. Webb, 657 P.2d 1102 (ID 1983); Brinkman v. Moskowitz, 238 N.Y.S. 2d 876 (1962); HSU v. Parker, 688 N.E.2d 1099 (OH 1996).

<sup>6</sup> Professors Hazard and Hodes say the requirements of notification, delivery and accounting under Model Rule 1.15(b) are *fiduciary* duties of a lawyer holding client funds. The Law of Lawyering, Third Edition, Geoffrey C. Hazard and W. William Hodes, Aspen Publishers (2003).

obligate the lawyer to make payment from the recovery in accordance with the promise. In the Matter of Moore, 4 P.3d 664 (NM 2000); In the Matter of Norman, 708 N.E.2d 867 (Ind. 1999); The Florida Bar v. Silver, 788 So.2d 958 (Fla. 2001); In the Matter of Kirby, 766 NE2d 351 (Ind. 2002).

Similarly, a “medical lien”<sup>7/</sup> is an “interest” in the personal injury recovery funds. Ladenheim. A “medical lien” refers to an oral or written promise to pay the medical provider from the plaintiff/patient’s personal injury recovery. It is not a statutory lien. Rather it is a type of contractual or equitable lien.

Although most “medical liens” appear to be created by consensual contract or equitable estoppel, Nevada has created a hospital lien by statute. NRS 108.590 et seq. Naturally, the holder of a hospital lien would have an “interest” in the funds.

A final example of a type of legally recognized “interest” in funds held by an attorney is a “subrogation lien”: an obligation by the plaintiff client to reimburse the source of payment of the plaintiff’s medical expenses. Hotel Employees v. Gentner, 815 F.Supp. 1354 (D. Nev. 1993).

Aside from what rises to the level of an “interest”, the lawyer who receives funds has no ethical duty to affirmatively seek to discover third parties with an interest in the funds before paying them out. The lawyer’s ethical obligations toward third parties only extend to interest holders of whom the lawyer has actual knowledge. D.C. Bar Opinion No. 293 (1999); Conn. Bar Ethics Opinion 95-20 (1995). Thus, the lawyer’s knowledge that his client owes bills – even if the lawyer knows that a creditor (without a promise by the client or lawyer) expects payment of the personal injury recovery – does not give rise to an “interest” in the funds by the creditor. Utah Bar Ethics Opinion No. 00-04 (2000).

Are the defense lawyer’s ethical duties under SCR 165 the same with respect to the claims of the plaintiff’s creditors as those of the plaintiff’s lawyer? Does the defense lawyer who is holding settlement funds to be paid to the plaintiff have ethical duties under SCR 165 when that lawyer has actual knowledge of a claim by a third party creditor – such as a medical provider to the plaintiff – to the funds to be paid to the plaintiff or the plaintiff’s lawyer? Does the defense lawyer have a duty to notify and pay the plaintiff’s creditor? Under SCR 165, even if the creditor has an interest in the settlement funds when received by the plaintiff’s attorney – so that the plaintiff’s attorney has ethical duties under SCR 165 toward that creditor – that creditor has no

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<sup>7</sup> The recent Nevada cases of Gumm v. Mainor, 118 Nev. 912, 59 P.3d 1220 (2002), and Michel v. Eighth Judicial District Court, 117 Nev. 145, 17 P.3d 1003 (2001), used the term “medical lien” without discussing how it arises.

interest in the funds in the hands of the defense attorney who made no promises of payment to the medical provider.

If a creditor does have an “interest” in client funds, the client’s attorney is ethically obligated to notify the claimant when such funds are received by the lawyer. SCR 165(2). Silver; Gentner. And this obligation is breached even if the lawyer did not intentionally fail to give the required notice. Intent is not a requirement under SCR 165(2). Silver.

Under SCR 165(2), the lawyer has the ethical duty to “promptly” pay the funds to the persons with an interest in them. While there is no bright-line test for “promptness”, it has been held that the lawyer’s 11 month delay was not “prompt.” In re Ross, 658 A.2d 209 (D.C. App. 1995).

When the client instructs the client’s lawyer not to pay a third party who appears to “have” a cognizable “interest” in the funds, there is a “dispute” concerning their respective interests in the funds. In that situation, the lawyer is ethically obligated not to decide who prevails in the dispute. The lawyer may ethically attempt to mediate a consensual settlement between the client and the third party. But if the parties do not readily agree to a resolution of the dispute, the lawyer is ethically obligated to keep the portion of the funds in dispute separate until the dispute is resolved. SCR 165(3). One ethical method of keeping the disputed portion separate and resolving the dispute is for the lawyer to interplead the funds under NRCP 22 and request a court to direct the distribution of the funds. Achrem; Moore; Ladenheim.

Finally, if the type of third party creditor that the client’s dispute is with, is the holder of a statutory hospital lien or a non-statutory medical lien, an attorney’s lien under NRS 18.015 has priority over those types of liens under NRS 108.600. Michel v. Eighth Judicial District Court, 117 Nev. 145, 17 P.3d 1003 (2001). Therefore, it is ethical for the lawyer to make payment to the lawyer under a fee agreement prior to the resolution of the dispute.