WHOSE MONEY IS IT – ATTORNEY DUTIES REGARDING FUNDS OF "OTHER PERSONS"

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The good news is that you just obtained a great settlement for your client. Unfortunately, your initial elation over the settlement is quickly dampened when your client instructs you not to pay certain lienholders. What to do? What is your potential exposure to civil liability? Even more importantly, what is your potential exposure to discipline by the State Bar? The answer depends on the type of lien which is involved, whether you signed the lien, and other factors.

First, it is important to remember that trust account duties are owed not only to clients, but also to a non-client who is an "other person to whom the lawyer owes a contractual, statutory, or other legal duty." [Rules of Prof. Conduct, rule 1.15(a).[1]] Therefore, until you determine what to do with funds which *might* belong either to your client or to an "other person" as described in rule 1.15(a), you must deposit them in your trust account. Then, you must "promptly distribute, as requested by the client or other person, any undisputed funds or property" in your possession, which "the client or other person is entitled to receive." [Rules of Prof. Conduct, rule 1.15(d).]

The Professional Rules of Conduct incorporate Evidence Code section 175 for the definition of "person," but do not provide a definition of "other person," nor do the Rules describe what "contractual, statutory, or other legal duty" means for purposes of rule 1.15(a). Comment 1 following rule 1.15 offers some guidance, however. It provides in part:

> Whether a lawyer owes a contractual, statutory or other legal duty under paragraph (a) to hold funds on behalf of a person* other than a client in situations where client funds are subject to a third-party lien will depend on the relationship between the lawyer and the third-party, whether the lawyer has assumed a contractual obligation to the third person* and whether the lawyer has an independent obligation to honor the lien under a statute or other law.

[Rules of Prof. Conduct, rule 1.15, Comment 1.] This tells us there are at least two situations in which you must pay the appropriate funds to the "other person." The first is when you have a contractual obligation to do so, meaning that you (not just your client) signed the lien. In fact, case law tells us that failing to pay the lienholder could result not only in civil liability to the lienholder, but also in discipline by the State Bar. [See *Johnstone v. State Bar* (1996) 64 Cal.2d 153, 155-156; *Crooks v. State Bar* (1970) 3 Cal.3d 346, 355; *Matter of Riley* (Rev.Dept. 1994) 3 Cal. State Bar Ct. Rptr. 91, 110-112 ("*Riley*").] The fact that your client instructed you ***not*** to pay

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[1]Changes to rule 1.15 have recently been proposed by the State Bar of California Board of Trustees. Read future issues of *Update* for more information on this.

a lienholder makes no difference. The attorney's duty to withhold funds to satisfy a lien applies even where the client demands payment of the lien amount. *[Matter of Respondent P* (Rev.Dept. 1993) 2 Cal. State Bar Ct. Rptr. 622, 630-632; see Cal. State Bar Form.Opn. 1988-101 (suggesting the attorney file an interpleader action).] You also have a duty to give the lienholder(s) notice of receipt of the funds.

The second situation in which you must pay the funds to the "other person" is when 1) you are aware of the existence of the lien, and 2) you have an independent obligation to do so under a statute or other law. This is a bit more complicated, since you have to determine whether there is such an "independent obligation." Statutory liens may arise under Labor Code section 3856 (workers' compensation lien), Welfare and Institutions Code sections 14124.72-14124.791 (Medi-Cal lien), Government Code section 13963 (lien for state restitution fund payments to crime victims), Government Code section 23004.1 (lien for county medical benefits), and Civil Code sections 3045.1-3045.6 (hospital liens), among others. Some of these statutes specifically require you to provide notice to the lienholder regarding settlement and/or impose other duties. Even where there is no statutory requirement to provide notice, you must still promptly do so pursuant to rule 1.15(d)(1). Failure to comply with a statute regarding payment to the lienholder despite having knowledge of the lien is a cause for discipline. [*Riley* at 112.]

What about the rather troubling "or other law" part of Comment 1 to rule 1.15. What does this cover? One thing it covers is equitable liens. The next obvious question is, "What is an equitable lien?" Unfortunately, there is no clear answer. An equitable lien is a right to subject property not in the possession of the lienor to the payment of a debt as a charge against that property." [*Farmers Ins. Exch. v. Zerin* (1997) 53 Cal.App.4th 445, 453 ("*Farmers*").] An equitable lien may arise from a contract which "reveals an intent to charge particular property with a debt or out of general considerations of right and justice as applied to the relations of the parties and the circumstances of their dealings." [*Ibid*.] Whether an equitable lien has arisen under particular circumstances depends on the facts of the case. [*Ibid*.]

Fortunately, a client's promise to pay from a specific fund does not itself create an equitable lien against the fund, absent "detrimental reliance or unjust enrichment." [*Farmers* at 457.] An attorney receiving settlement proceeds or other funds on behalf of a client is not obligated to satisfy the client's debts out of those funds. "It is only when the creditor has some property interest in the fund or a trust relationship exists that such an obligation might arise." [*Farmers* at 459.]

What about a situation where you did not sign the lien (only your client signed), and you do not have an independent obligation pursuant to a statute or other law? You would most likely not be disciplined for failing to honor a contractual lien between your client and a third party when you did not sign the lien. This is because where only the client has signed the lien, and the attorney has no statutory or other legal duty to the lienholder, the lienholder is not an "other person" under rule 1.15(a). [Tuft, Peck & Mohr, Cal. Prac. Guide: Professional Responsibility (The Rutter Group 2021) p. 9-71, ¶ 9:319.1] To date, no known reported case has imposed discipline on an attorney in this situation. [*Id*. at p. 9-70, ¶ 9:319.] Unless the court determines there is an equitable lien (as in *Kaiser Foundation Health Plan, Inc. v. Aguiluz* (1996) 47 Cal.App.4th 302), you would most likely not be held civilly liable, since you generally have no obligation to satisfy your client's debts. [*Farmers* at 459.]

What is the safe thing to do when faced with conflicting demands from your client and a lienholder, where you think you might possibly have an obligation to the lienholder? There are two possible options:

1) Commence an interpleader action. [See Cal. State Bar Form.Opn. 1988-101.]

2) If, and only if, both the client and the lienholder agree, keep the disputed funds in the trust account until the dispute is resolved. [Tuft, Peck & Mohr, Cal. Prac. Guide: Professional Responsibility (The Rutter Group 2021) p. 9-75, ¶ 9:340.]

A possible way to avoid this situation in the future would be to include language in your retainer agreement stating your position regarding third-party liens. You could state, for example, that if presented with liens signed by the client, and which you believe to be valid, you will pay the lienholder out of the settlement funds. (It would be wise to have the client initial next to this clause.) It would also be a very good idea to inquire regarding the existence of liens prior to accepting the case, as payment of liens could quickly deplete settlement funds.

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