

KENTUCKY BAR ASSOCIATION

Ethics Opinion KBA E-458

Issued: March 15, 2024

The Rules of Professional Conduct are amended periodically. Lawyers should consult the current version of the rule and comments, SCR 3.130 (available at <http://www.kybar.org/237>), before relying on this opinion.

Subject: Lawyers' Obligations Regarding Client Funds Held by the Lawyer to Which Third Persons Claim An Interest

Question 1: What are the lawyer's obligations and the lawyer's permitted course of action when holding client funds to which a third party claims a legal or an equitable interest in the client funds?

Answer: The KBA Ethics Committee members have received recurring inquiries concerning the obligations of the lawyer who holds client funds in the lawyer's trust account when there are third parties who claim entitlement to some or all of those funds. These third-party claims range from medical provider services, litigation funding client loan agreements, common law and contractual subrogation claims to federal and state statutory liens such as through the Center for Medicare Services, ERISA, and child support obligations. Frequently, the lawyer's inquiry follows a client's demand to disburse the funds without addressing the third-party claims. On some occasions the client has discharged the lawyer for not disbursing the disputed client funds and then demands the client funds then be sent to the client without honoring an otherwise valid lien or other obligation.

Effective January 1, 2014, the Supreme Court of Kentucky amended SCR 3.130(1.15(b) & (c)) to delete references in Rule 1.15 to "third person" claims against client held funds.¹

Prior to the 2014 Amendment, Rule 1.15 generally followed the ABA Model Rule 1.15(b) & (c), with some clarifications regarding third-party claims against client held funds, and directed the lawyer to hold disputed claimed funds pending the resolution of the claim.² Thus, before the 2014 amendments to this Rule, the answer to the basic question discussed in this opinion was clear: If a third-party made claims to funds held by a lawyer, the lawyer was obligated ethically to hold the disputed funds in trust pending resolution of the claims. While the lawyer could defer the resolution to the client as a matter for the client to resolve, often the lawyer felt like a "collection agent" for the third-party claimant. The 2014 amendments removed this burden from the lawyer as a matter of *professional conduct*, but it did not change any legal responsibility of the lawyer who is holding client funds that may be subject to liens or other legal claims.

SCR 3.130 (Rule 1.15) currently reads:

Safekeeping property.

(a) A lawyer shall hold property of clients or third persons that is in a lawyer's possession in connection with a representation separate from the lawyer's own property. Funds shall be kept in a separate account maintained in the state where the lawyer's office is situated, or elsewhere with the consent of the client, third person, or both in the event of a claim by each to the property. The separate account referred to in the preceding sentence shall be maintained in a bank which has agreed to notify the Kentucky Bar Association in the event that any overdraft occurs in the account. Other 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.

(b) *Upon receiving funds or other property in which a client has an interest, a lawyer shall promptly notify the client. 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 any funds or other property that the client is entitled to receive and, upon request by the client, shall promptly render a full accounting regarding such property.*

(c) *When in the course of representation a lawyer is in possession of funds or other property in which the lawyer and client claim interests and are not in agreement regarding those interests, the funds or other property in dispute shall be kept separate by the lawyer until the dispute is resolved. The lawyer shall promptly distribute all portions of the funds or other property in which the interests are not in conflict.*

(d) A lawyer may deposit the lawyer's own funds in a client trust account for the sole purpose of paying bank service charges on that account, but only in an amount necessary for that purpose.

(e) Except for advance fees as provided in 1.5(f), a lawyer shall deposit into a client trust account legal fees and expenses that have been paid in advance, to be withdrawn by the lawyer only as fees are earned or expenses incurred.

Emphasis Added.

Thus, a lawyer follows the Rules of Professional Conduct by disbursing client funds to the client as instructed by the client. See Rule 1.15(b). However, Rule 1.15(b) only directs the lawyer to “. . . promptly deliver to the client any funds or other property *that the client is entitled to receive. . .*” The Rule does not require the lawyer to deliver funds or property to the client to which the client is not entitled to possess due to a common law or statutory claim or lien, particularly if by making the distribution the lawyer could become personally liable.

The significance of this 2014 change is that under Rule 1.15(b) and (c) as it existed previously, a lawyer was required to hold funds belonging to a client to which a third-party claimed an interest until the claim was resolved. The amendment to Rule 1.15 deletes the reference to a “third

person”. Therefore, under the Rules of Professional Conduct, a lawyer is relieved of any ethical duty to the third-party claimant to resolve the third-party’s claim and may disburse the funds to the client without necessity of resolution of the third person’s claim. However, Rule 1.15 does not require the lawyer to disburse the funds to the client if the lawyer is legally obligated to pay the funds over to a third party.

The Supreme Court did not modify the Official Comments to Rule 1.15. Comment 5 states:

The obligations of a lawyer under this Rule are independent of those arising from activity other than rendering legal services. For example, a lawyer who serves only as an escrow agent is governed by the applicable law relating to fiduciaries even though the lawyer does not render legal services in the transaction and is not governed by this Rule.

Emphasis Added.

It is beyond the purview of the Ethics Committee to determine what third-party claims should be resolved before the lawyer distributes client funds. But it is the opinion of the Committee that a lawyer does not violate the Rules of Professional Conduct by holding disputed funds pending determination of the legal rights of lien holders and statutory obligations. This could include such claims to the funds as Child Support obligations, ERISA, Medicare, Medicaid, *etc.* This reference to potential claims is meant only as a descriptive list, neither inclusive nor exclusive of potential obligations. The appropriate inquiry for the lawyer is whether the lawyer as a fiduciary will be held liable personally for having made the distribution (and possible dissipation by the former client) of monies to a third-party claimant has a legal right.

Rule 1.15(c) also allows the lawyer to hold disputed funds in which the lawyer claims an interest. Comments 1 and 2 state:

[1] A lawyer should hold property of others with the care required of a professional fiduciary. Securities should be kept in a safe deposit box, except when some other form of safekeeping is warranted by special circumstances. *All property which is the property of clients or third persons, including prospective clients, must be kept separate from the lawyer's business and personal property and, if monies, in one or more trust accounts.* Separate trust accounts may be warranted when administering estate monies or acting in similar fiduciary capacities. A lawyer should maintain on a current basis books and records in accordance with generally accepted accounting practice and comply with any recordkeeping rules established by law or court order. See, e.g., ABA Model Financial Recordkeeping Rule.

[2] Lawyers often receive funds from which the lawyer's fee will be paid. The lawyer is not required to remit to the client funds that the lawyer reasonably believes represent fees owed. However, a lawyer may not hold funds to coerce a client into accepting the lawyer's contention. *The disputed portion of the funds must be kept in a trust account and the lawyer should suggest means for prompt resolution of the dispute, such as arbitration.* The undisputed portion of the funds shall be promptly distributed.

Occasionally, the members of the Ethics Committee receive an inquiry from a lawyer whose client has discharged the lawyer for failure to disburse funds to the client in the face of an otherwise valid lien. SCR 3.130 (Rule 1.16) states:

Declining or terminating representation.

(a) Except as stated in paragraph (c), *a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if:*

- (1) the representation will result in violation of the Rules of Professional Conduct or other law; or
- (2) the lawyer's physical or mental condition materially impairs the lawyer's ability to represent the client; or
- (3) *the lawyer is discharged.*

Emphasis Added.

But Rule 1.16 also provides:

(c) A lawyer must comply with applicable law requiring notice to or permission of a tribunal when terminating a representation. When ordered to do so by a tribunal, a lawyer shall continue representation notwithstanding good cause for terminating the representation.

(d) *Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client's interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled and refunding any advance payment of fee or expense that has not been earned or incurred. The lawyer may retain papers relating to the client to the extent permitted by other law.*

Emphasis Added.

Once the client has discharged a lawyer, the lawyer no longer has authority to act on behalf of the client. But the lawyer remains obligated to provide an accounting of client funds under Rule 1.15(a) and to surrender property (client funds) “to which the client is entitled.” Thus, a lawyer may account for and hold client funds when the former client’s obligations could subject the lawyer to a personal liability if not satisfied through the client’s funds.

Conclusion

In sum, a lawyer would not violate the Rules of Professional Conduct by satisfying common law, statutory, or other enforceable lien claims or obligations from funds held in the lawyer’s trust account so as to insure that the lawyer is not held personally liable for the client’s obligation. In these circumstances the lawyer would be well advised to seek a determination from a court or

other tribunal of the validity and amount of the lien or other legal obligation affecting the client's funds before disbursing the funds.

The Rules of Professional Conduct address only the ethical duties of an attorney in Kentucky, not the substantive law on liens, subrogation claims, client contracts, ERISA liens, Medicare/Medicaid issues, or child support claims or liens, *etc.* The legal viability of those types of claims must be assessed by the lawyer on a case-by-case basis. It would be appropriate for lawyers to consider, when preparing their engagement letters, adding a provision explaining the lawyer's legal obligations in disbursing client funds.

Note

To the extent that Formal Opinion KBA Ethics Op. 383 (1995) was based upon SCR 3.130 (Rule 1.15) as it existed prior to the 2014 Amendment to Rule 1.15 and is inconsistent with this Opinion, this Opinion controls.

Note to Reader

This ethics opinion has been formally adopted by the Board of Governors of the Kentucky Bar Association under the provisions of Kentucky Supreme Court Rule 3.530. This Rule provides that formal opinions are advisory only.

¹ Order 2013-12, effective January 1, 2014 [Note: *The bracketed and underlined language appears in the June 19, 2013 Supreme Court Rules Hearing presentation as the proposed amendment to SCR 3.130(Rule 1.15).*]

XIII. SCR 3.130(1.15)(b) and (c) Safekeeping property

Sections (b) and (c) of SCR 3.130(1.15) shall read:

(b) Upon receiving funds or other property in which a client [or third person] has an interest, a lawyer shall promptly notify the client [,third person, or both in the event of claims by each to the property]. Except as stated in this Rule or otherwise permitted by law or by agreement with the client [third person, or both in the event of a claim by each to the property] 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.

(c) When in the course of representation a lawyer is in possession of funds or other property in which [two or more persons (one of whom may be the lawyer)] the lawyer and client claim interests and are not in agreement regarding those interests, the funds or other property in dispute shall be kept separate by the lawyer until the dispute is resolved. The lawyer shall promptly distribute all portions of the funds or other property in [as to] which the interests are not in conflict [dispute].

²The KBA Ethics 2000 Committee Report contains the following discussion of the then proposed Rule 1.15 as compared to the Model Rule 1.15 at pp. 1-170-1-171:

3. Discussion and Explanation of Recommendation:

a. Comparison of proposed Kentucky Rule with its counterpart ABA Model Rule.

(1) *The proposed KRPC 1.15 is consistent with MR 1.15 with these exceptions:*

(a) *Language has been added to paragraphs (a), (b), and (c) of the Rule clarifying responsibilities when there is a claim by both a client and third party for funds held by a lawyer.*

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- (b) Language has been added to Comment [4] that allows a lawyer to deposit funds for restitution for conversion of client funds caused by others.
 - (c) Committee drafted new Comment [5] is added to amplify paragraph (c) of the Rule concerning when funds must be deposited in a client trust account.
 - (d) Language has been added to Comment [3] that provides additional guidance for resolving third party claims against client funds.
 - (e) MR Comment [6] (Ed. Note: This is Comment [5] in current KRPC 1.15.) is deleted because its guidance on a client security fund is not applicable to Kentucky.

b. Detailed discussion of reason for variance from ABA Model Rule (if any).

The proposed KRPC 1.15 variances from MR 1.15 are for the purpose of clarifying and expanding guidance on lawyer duties in managing client funds. These additions were determined to be necessary based on bar disciplinary cases and the numerous questions lawyers have asked the Ethics Hotline about client trust account management and the claims of lien holders and the like. Additionally, the Committee retained the organization of the current KRPC 1.15 for continuity in citation of the Rule in CLE and disciplinary matters.

Emphasis Added.