

Issues Presented: How should a Lawyer resolve a dispute between a client and a third party regarding ownership of funds in the Lawyer's custody?

Answer: Lawyer should utilize interpleader or some other procedure to obtain a determination regarding ownership of the funds from a Court of competent jurisdiction and in any event must not resolve the issue personally.

Rules Implicated: 1.7, 1.15 1.16.

### **FACTS**

Client retains Lawyer to represent Client in filing for Chapter 7 bankruptcy. Client's significant other (but not spouse) pays the retainer with Client's knowledge and consent. For various substantive legal reasons, Lawyer instructs Client to delay filing for bankruptcy. Client's significant other subsequently becomes "ex" significant other and demands Lawyer refund the retainer to the "ex." Client opposes this and wants Lawyer to continue to provide services paid for with the disputed funds.

### **DISCUSSION**

Although arising in a different context, the Committee has addressed the fundamental issue(s) presented by this inquiry (i.e., a dispute between a client and a third party about funds in the Lawyer's custody) in Opinion 1998-3. The Committee addressed the issue under Rule 1.15(c) of the South Dakota Rules of Professional Conduct, which reads slightly different now, but presents the same general policies:

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.<sup>1</sup>

SDCL Ch. 16-18 Appx. A, Rule 1.15(c).

The Committee specifically noted and applied a comment to Rule 1.15, now found in Comment [4], which is worded differently now but, again, presents the same general principles as before;

"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. A lawyer may have a duty under applicable law to protect such a third-party claims [*sic*] against wrongful interference by the client. In such cases,

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<sup>1</sup> The version of Rule 1.15(c) then in effect stated "[w]hen in the course of representation, a lawyer is possession of property in which both the lawyer and another person claim interest, the property shall be kept separate by the lawyer until there is an accounting and severance of their interests. If a dispute arises concerning their respective interests, the portion in dispute shall be kept separate by the lawyer until the dispute is resolved."

when the third-party claim is not frivolous under applicable law, the lawyer must refuse to surrender the property to the client until the claims are resolved. A lawyer should not unilaterally assume to arbitrate a dispute between the client and third party, but, when there are substantial grounds for dispute as to the person entitled to the funds, the lawyer may file an action to have a court resolve the dispute.<sup>2</sup>

SCL Ch. 16-18 Appx. A, Rule 1.15(c) cmt. [4].

The Committee then noted that whether a client or third party is entitled to funds in the Lawyer's custody is a matter of substantive law outside the Committee's purview. Based on this, the Committee stated that if the lawyer in that fact pattern thought a genuine dispute might exist between the client and third party regarding proper disposition of the proceeds, the Lawyer had to retain possession of the funds until that issue was resolved, and then cited a New York state law case discussing the "hazards inherent in unilaterally resolving a 'dispute.'" (Opinion 1998-3 (citing *Leon v. Martinez*, 638 N.E.2d 511 (N.Y. 1994).))

The Committee believes that the rationale of Opinion 1998-3, given revised Comment [4] to Rule 1.15, resolves this inquiry, notwithstanding somewhat different facts. In any dispute between a client and a third party regarding ownership of funds in the Lawyer's possession, Lawyer may have formulated a legal opinion regarding which party is correct. But this is a matter of substantive law on which the Committee cannot opine. More important, Lawyer is not authorized to make or act on that determination either. Rule 1.15(c) clearly states the disputed "property shall be kept separate by the lawyer until the dispute is resolved," and the relevant comment states the Lawyer should not arbitrate the dispute personally. Given the statement in Comment [4] to Rule 1.15 that Lawyer may file an action to have a court resolve the dispute, the Committee's opinion is that filing an interpleader or other action seeking a court's resolution of this matter would be most appropriate if the third party and Client cannot otherwise agree.

Lawyer should also consider other Rules implicated by this situation. To the extent Lawyer seeks court resolution of the dispute and the Client objects or demands the Lawyer act otherwise, the Lawyer may have to terminate representation because of a "material limitation" present conflict under Rule 1.7(a)(2), (which is potentially unwaivable under Rule 1.7(b)(1)), and Rule 1.16(a)(1) (representation will cause violation of the Rules).

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<sup>2</sup> In 1998, the relevant comment read "[t]hird parties, such as a client's creditors, may have just claims against funds or other property in a lawyer's custody. A lawyer may have a duty under applicable law to protect such third-party claims against wrongful interference by the client, and accordingly may refuse to surrender the property to the client. However, a lawyer should not unilaterally assume to arbitrate a dispute between the client and third party."

It is notable, for reasons discussed in more detail below, that the phrase "the lawyer may file an action to have a court resolve the dispute" did not appear in the Comments to Rule 1.15 at the time the Committee issued Opinion 1998-3.

## **CONCLUSION**

In conclusion, if there is a dispute between a third party and a client regarding the proper disposition of funds in the Lawyer's possession, the Lawyer may, and should, ask a Court to resolve the dispute, such as by filing an interpleader action as contemplated by SDCL § 15-6-22 and, in any event, may not resolve that dispute personally.