





Who is Entitled to the Money?

Handling Disbursements in Personal Injury Cases

By Michael Sartip

George Burns said when you get older, you lose two things. The first is your memory. After a pause, he was asked about the second. He said, "I don't remember." Most of us have read the Rules of Professional Conduct and the cases applying the rules, but many of us do not recall them.

The purpose of this article is to refresh your memory and provide some guidance for risks that may arise when disbursing settlement proceeds from an accident claim. The risks are two-fold. First, lawyers have potential civil liability. The South Carolina courts have held that a lawyer has personal liability for disbursing funds to his client when he has knowledge of his client's assignment of proceeds to a third party.¹ This case involved an assignment of proceeds to a third-party lender, but the holding appears to apply to all third parties. The courts indicated that a lawyer has a fiduciary duty to a third party as an escrow agent. The courts based their decisions to hold

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an attorney personally liable on contract law principles applicable to assignments and the Rules of Professional Conduct.

Second, lawyers have potential exposure to discipline under the Rules of Professional Conduct. This article will focus on providing guidance to avoid the second risk.

Who is entitled to the money?

The most common fact scenario involves an individual who suffers personal injuries in an accident, is treated at a hospital, and incurs substantial medical expenses. Thereafter, the individual retains a lawyer to represent his/her interests against the responsible party. The lawyer then uses the medical bills as an element of damages to secure a settlement from the responsible party's insurance carrier. Often, there is insufficient insurance coverage, or the settlement may not meet the client's expectations of recovery. To no one's surprise, the client wants as much money as possible. The law-

yer seeks to maximize the amount of the disbursement to the client, but medical bills, subrogation liens, litigation costs and fees also must be resolved.

As a result, a question uppermost in the mind of many lawyers during the disbursement process is: "How do I maximize the payment to my client while still complying with my legal and ethical responsibilities?" This tends to raise a related question: "Who can I avoid paying or at least reduce the amount?" In handling disbursements, lawyers must realize that the duty of loyalty to the client is only one of the duties that needs to be considered and discharged. The disbursement of settlement proceeds necessarily implicates the duty of safekeeping property. This, in turn, implicates a duty owed to a third party who asserts a claim and whose interests may be adverse to the client's interests. Resolving this conflict necessitates that the disbursing lawyer carefully answer this key question: "Who is entitled to the money?"

Rule 1.15 of the South Carolina Rules of Professional Conduct

Our Rules of Professional Conduct address the duties that a lawyer has to third parties in connection with the disbursement of settlement proceeds. Rule 1.15(d) and (e) and the accompanying comments note the various ownership interests in the funds held by the lawyer. Rule 1.15(d) provides that when a lawyer receives property belonging to others, two duties arise: (1) the duty to notify promptly those who have an interest in the proceeds held in trust by the lawyer; and (2) the duty to deliver promptly the proceeds and provide an accounting upon request.²

Rule 1.15(e) focuses on a lawyer's duties when a lawyer receives notice before or during the disbursement process that there is a dispute as to who is entitled to the funds.³ Comment [4] to Rule 1.15 elaborates on the rule by providing that:

"... 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 third-party claims against wrongful interference by the client. In such cases, 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 the 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."

Analysis

For a lawyer handling disbursements in a personal injury settlement, third-party claims ordinarily fit into one of three categories: (1) third-party claims that are valid and not in dispute, (2) third-party claims that appear to be valid, but are in dispute, and (3) third-party claims that the lawyer believes are frivolous under applicable law.

An example of a claim that is valid and not in dispute is as follows: A lawyer is on notice of the client's signature on a specific assignment to the medical provider which assigns proceeds from a settlement or judgment to the medical provider. The client agrees to pay the medical bills out of settlement. If the client does not dispute payment of the third party's claim, the Rules of Professional Conduct require the lawyer to deliver the funds to the third party. The Rules also provide that a lawyer has a duty to provide an accounting, such as a proposed disbursement statement, upon the request of a third party asserting a claim. The duty to pay the third party under Rule 1.15(d) does not prohibit a lawyer from seeking in good faith to negotiate downward the third party's claim in order to allow a greater recovery by the lawyer's

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An example of a claim that is valid but in dispute is as follows: The client instructs the lawyer not to pay a medical provider even though the lawyer is on notice that the client has assigned proceeds from a settlement or judgment to the medical provider. Because there is a dispute, a lawyer's duty to safeguard contested funds or proceeds is triggered. The lawyer should not "unilaterally assume to arbitrate a dispute between the client and a third party."⁴ The lawyer should not release those funds without the agreement of all parties involved or a court determination of who is entitled to receive them. If there is no agreement, Rule 1.15(e) appears to obligate the lawyer to file a petition or an interpleader action to resolve the matter. If only a portion of the third-party payment is in dispute, the undisputed portion must be disbursed and not withheld. A more troubling ethical aspect in such a case arises if the attorney advises his client to "dispute" what would otherwise be a valid claim in order

to prevent or delay a permissible payment to the third party asserting a claim.

The third category arises when a lawyer legitimately views a third-party claim to be frivolous. There are various fact patterns that may give rise to such a finding. This was the topic of South Carolina Ethics Advisory Opinion 16-01. The facts provided in this Opinion are very limited. The only question presented was whether a personal injury lawyer has the right to refuse to protect a hospital's claim to settlement proceeds if that lawyer believes in good faith that the hospital's claim is frivolous. This Opinion states that "there was a dispute and the lawyer believed in good faith that the assignment was invalid and the hospital's claim was frivolous." Reasoning from Comment [4] to Rule 1.15, the Ethics Advisory Committee opined that a personal injury lawyer may refuse to honor a hospital's claim if the lawyer believes in good faith that the hospital's claim is frivolous, but acknowledged that the

relevant language created "much room for debate" and advised that a lawyer who refuses to protect the third-party claim based on his view that it is frivolous may be placing himself at risk.

Ethics Advisory Opinion 16-01, as is not uncommon in the law, hinges on definitions of key terms, specifically "good faith" and "frivolous." Lawyers deal with both terms on a regular basis, and in this situation, the attorney is placed in a rather difficult position. A lawyer is an advocate for the client in the personal injury case. However, once the lawyer has the proceeds in a trust account, this position changes vis-a-vis the money. The mere existence of the two sections of Rule 1.15 illustrates that lawyers frequently find themselves holding money in which two or more parties claim an interest. The language in the comments that states that lawyers should "not unilaterally assume to arbitrate a dispute between the client and the third party" makes it clear that, at that point, the role of advocate

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has changed to that of a fiduciary holding the funds. If a lawyer disburses disputed funds because she believes the third party's claim is frivolous, the lawyer has assumed the role of arbitrator of the merits of the dispute.

Ethics Advisory Opinion 16-01 did not define the term "frivolous." However, in a previous opinion, the Ethics Advisory Committee defined "frivolous" as follows:

"lacking a legal basis or legal merit; not serious; not reasonably purposeful." Black's Law Dictionary 303 (3d pocket ed. 2006); see also 20 C.J.S. Costs § 17 (2009) ("A claim ... is frivolous if its proponent can present no rational argument to support it or failed to make a reasonable inquiry into its basis ...").

A common scenario giving rise to this issue exists when a lawyer has notice of an assignment of proceeds signed by someone other than the client. The lawyer may consider that such an assignment is unenforce-

able on its face; therefore, the medical provider's claim is insufficient. Before determining that the claim is frivolous, however, the lawyer should confirm that the third-party claimant can present no rational argument to support its claim. If the lawyer fails to do so, the lawyer is placing himself in peril. In other words, if the third-party claimant has articulated a rational argument and basis for its claim, then the lawyer will not be able to form a good faith belief that the claim is frivolous. For example, the third-party claimant may rely on a 2014 South Carolina Supreme Court opinion that held that a family member who is authorized to make health care decisions is also authorized to bind the principal to an obligation to pay for the medical services.⁵

Further, a third-party claimant may also have substantial grounds for a dispute under agency principles if the facts support it. One theory that may relate to the execution of an assignment is ratification. "Ratification, as it relates to the law of agency, may be defined

as the express or implied adoption and confirmation by one person of an act or contract performed or entered into on his behalf by another who at the time assumed to act as his agent."⁶

If there is a dispute concerning the rights of third parties to the client's funds and the lawyer has doubt as to whether there is a valid claim, a lawyer must follow Rule 1.15(e) and safeguard the funds until the dispute is resolved. The question of whether a client is entitled to funds in the possession of a lawyer is most often a question of law. The same is true for whether there is a valid claim or assignment. If it appears the dispute cannot be resolved amicably, the lawyer may either pay the funds into the court in the form of an interpleader or request the court determine who is legally entitled to the funds.

Another issue is whether a lawyer has a duty to protect the interests of a third party if a lawyer is simply aware of a third party who is owed money. For exam-

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ple, a lawyer may be aware of the client's medical bills but have no actual knowledge of a third party's lawful claim to an interest in funds collected in a personal injury action. According to one South Carolina Ethics Advisory opinion, actual knowledge of a third party's interest in a claim is required. (See South Carolina Ethics Advisory Opinion FAQs Question 3.) If the attorney is simply aware that the client has creditors or medical providers, but has not received notice of a claim, the Ethics Advisory Committee has advised that the third party is not entitled to receive funds or property. The lawyer may properly disburse to the client, although the Committee noted that the lawyer should counsel the client regarding the client's obligations to creditors or medical providers.

Conclusion

Before making the decision to disburse personal injury proceeds from a settlement or judgment, ask the following question: Does the risk of being wrong outweigh the

benefit of being right? The risk of being wrong may result in disciplinary proceedings or litigation. The benefit of being right may be temporary. The injured client may be temporarily satisfied with the amount of money received. The client may be more satisfied with the outcome, but that satisfaction may come to an end when third-party creditors pursue their claims against your former client in collection proceedings or in court after disbursement. In most cases, making a unilateral determination that the third-party claim is frivolous is not worth the risk of being wrong. When there is a dispute, the safest course of action is for lawyers to recognize both their ethical responsibilities and fiduciary position. A court order to disburse proceeds from your escrow account eliminates the exposure to a Rule 1.15 violation and the potential personal liability that may follow any mishandling of the funds.

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Beach. He gratefully acknowledges William O. Higgins for his contributions to this article.

Endnotes

- ¹ See *Moore v. Weinberg*, 388 S.C. 583, 681 S.E. 2d 875 (2009); *Moore v. Weinberg*, 373 S.C. 209, 644 S.E. 2d 740 (Ct. App. 2007).
- ² 1.15(d) "Upon receiving funds or other property in which a client or third person has an interest, a lawyer shall promptly notify the client or third person. 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 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." [Emphasis Added]
- ³ 1.15(e) "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."
- ⁴ See Rule 1.15 Comment 4.
- ⁵ See *Coleman v. Mariner Health Care, Inc.*, 407 S.C. 346, 352, 755 S.E.2d 450, 453 (2014).
- ⁶ *Fuller v. Eastern Fire & Casualty Ins. Co.*, 240 S.C. 75, 89, 124 S.E. 2d 602, 608 (1962).