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Co-Petitioners on behalf of the
Arizona Association for Justice

IN THE SUPREME COURT
STATE OF ARIZONA

PETITION TO AMEND ETHICAL RULE 1.15, RULE 42, RULES OF THE ARIZONA SUPREME COURT.	Petition No. _____

Petitioner Arizona Association for Justice, formerly known as the Arizona Trial Lawyers Association, consists of about 700 Arizona lawyers. It is the sole Arizona bar association specifically dedicated to protecting the

rights of tort victims and insurance consumers. Petitioner's members protect the rights of their clients and the public through continuing legal instruction and public education, through legislative presentations, through trial and appellate advocacy, and through the support of salutary changes to the procedural and ethical rules.

Under Arizona Supreme Court Rule 28, Petitioner respectfully asks the Court to amend Ethical Rule 1.15 ("Safeguarding Property") of Rule 42, Arizona Rules of the Supreme Court.

Petitioner is filing this Petition as an alternative to Petition No. R-11-0024, a related and still-pending petition that proposes amending Comment No. 4 to ER 1.15. While Petitioner supports adopting Petition No. R-11-0024, Petitioner proposes this new change for two reasons. *First*, it represents a compromise to the stakeholder concerns that Petition No. R-11-0024 has generated. *Second*, it may be simpler and best to go back to basics and revise the Ethical Rule itself instead of modifying Comment No. 4. In redline format, the attached Exhibit 1 reflects the proposed changes to ER 1.15(e).

Discussion

1. Ethical Rule 1.15(e) imposes an unfair and unreasonable burden by effectively creating a non-judicial prejudgment attachment of client property that is contrary to substantive Arizona law.

The present version of ER 1.15(e) provides:

> When in the course of representation a lawyer possesses 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.

ER 1.15's Comment No. 4 (version eff. Dec. 1, 2004) states:

> The Rule also recognizes that third parties may have just 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 has become a matured legal or equitable claim, 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.

Read together, ER 1.15(e) and Comment No. 4 imply that the burden is on a client's lawyer to file "an action" against a third party in the event of a third party "dispute" over client property in the lawyer's possession.[1] As a

[1] This is a bit of an oversimplification. In many cases the action would need to be filed against the lawyer's own client as well as against other claimants whose claims are not "disputed." Such litigation is both disruptive to the attorney-client relationship and unduly exposes legitimate claimants to unnecessary costs, sometimes forcing them to forfeit legitimate claims. Consider, as a common example, an automobile personal-injury, minimum-limits recovery of $15,000 where there is (i) a legitimate $500 ambulance company lien; (ii) a legitimate $2,000 doctor's office lien; (iii) a legitimate $5,000 AHCCCS lien; and (iii) a disputed $10,000 hospital lien. In this case, a lawyer might properly choose to file an interpleader action against all

result of that, ER 1.15(e) can have the practical effect of:

- freezing property—like a prejudgment writ of attachment—without providing the many statutory guidelines and protections offered in the writ-of-attachment process;
- preventing clients from accessing funds that otherwise belong to them;
- transforming a client's lawyer into a third party's collection agent; and
- making clients—particularly injured clients who are already typically under financial stress—vulnerable to illegitimate claims.

This is backwards, since the burden of prosecuting a legal action concerning a third party's claim is always on the third party. Where else should the burden fairly belong? The claim is, after all, the third party's claim—something for the third party to substantiate and prosecute. If that involves filing a judicial action, the burden of doing that properly rests on the third party.

Reading ER 1.15 as placing a burden to file a judicial action on the property-possessing lawyer freezes the property. But that is not the legitimate

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claimants and the lawyer's own client. Some of the legitimate claimants will make (logical) business decisions not to respond to the action because answering the complaint or hiring counsel outweighs the benefit of prevailing. Of course, another alternative might be to file a declaratory-relief action against the hospital, but that too is an imperfect solution unduly shifting the burden and expense of litigation onto the lawyer's client for reasons more fully discussed in the body of this Petition.

way to freeze someone else's property. The legitimate way to freeze someone else's property is through the writ-of-attachment process—a process operating under clear guidelines and providing strong due-process-of-law protections to the property's possessor.

After all, to obtain a writ of attachment that freezes property, the party seeking to attach the property ("attachment-plaintiff") must file a complaint against the property's possessor ("attachment-defendant"). The complaint must state many specific things, including the amount and character of the debt, the lack of any legal setoffs or counterclaims against the debt, and the unusual circumstances justifying freezing the property.[2] The affidavit must state that the attachment is not sued out for the purpose of injuring or harassing the attachment-defendant and that the attachment-plaintiff will probably lose his debt unless the writ of attachment issues.[3]

The well-known writ-of-attachment statutory process for freezing property that another person possesses gives the attachment-defendant an opportunity to deny the facts that the attachment-plaintiff is asserting.[4] At that point, the issues existing between the attachment-plaintiff and the

[2] A.R.S. § 12-1521(B).
[3] A.R.S. § 12-1521(C).
[4] A.R.S. § 12-1521(D).

attachment-defendant "shall be tried as other questions of fact."[5]

Moreover, before the court actually issues any writ of attachment, the attachment-plaintiff must execute and file a bond payable to the attachment-defendant in an amount not less than the amount for which the action is brought.[6] The judicial officer approving the writ of attachment must approve the amount of the bond, conditioned on the attachment-plaintiff prosecuting the claim against the attached property and the attachment-plaintiff paying all damages and costs that the attachment-defendant may sustain if the writ of attachment was obtained wrongfully.[7] In the end, if the judgment is in favor of the attachment-defendant, the trial court "shall fix and include in the judgment a reasonable attorney's fee and shall enter judgment therefor against the sureties upon the attachment bond."[8]

When ER 1.15 is interpreted to freeze client-owned property that an attorney possesses, not even one of the substantial protections of the statutory attachment process applies. Instead, ER 1.15 imposes the risk, burden, and expense upon the client (through the lawyer possessing the client's property) to judicially challenge unmeritorious claims against the client's property.[9]

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[5] A.R.S. § 12-1521(D).
[6] A.R.S. § 12-1524.
[7] A.R.S. § 12-1524.
[8] A.R.S. § 12-1521(E).
[9] The word "dispute" creates confusion between ER 1.15 and its

Based on the Rule and Comment, unless a lawyer wants to make a unilateral determination that a third-party claim lacks "substantial grounds"—something inherently treacherous and inconsistent with Comment 4's warning against unilaterally "arbitrating" such matters—the most specious of claims leave the property-possessing lawyer (and client) hamstrung. Those claims leave the property frozen solid with none of the writ-of-attachment process's guidelines and protections to thaw the impasse and protect the property owner.[10]

Faced with the prospect of instituting litigation or making nuisance-value payments to resolve such claims in personal injury cases, a client almost always chooses to pay *something* to end the problem. It's a brutal economic choice. If the client does not make the nuisance payment, the client's money

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Comment No. 4. Reading ER 1.15 by itself, one might logically think that "dispute" means that an action has already been filed by a third-party concerning the subject property. After all, if an action has not been filed, how could there be a "dispute"? But reading the last line of Comment No. 4, the word "dispute" is apparently intended to refer to a mere "disagreement" about how to disperse the property.

[10] Unlike the present Petition, Petition No. R-11-0024 seeks only to amend Comment No. 4 and, in a single sentence, creates a notice mechanism similar to the one proposed here. Petition No. R-11-0024, however, generated criticism over the fact that the "comment is not the rule," *i.e.*, that such a notice mechanism belonged in the "rule" itself and not in the "comment." *Cf.* Rule 42, Preamble ¶21 ("The Comments are intended as guides to interpretation, but the text of each Rule is authoritative."). Although this Court has amended comments in the past, including Comment No. 4, the present petition seeks to ameliorate this concern.

remains frozen. Since most clients desperately need their money and have waited to obtain it for months or years, they make the nuisance payments to unfreeze their money. And in those rare cases where litigation is brought to challenge unmeritorious claims, claimants who had been clamoring for payment routinely default or withdraw the claims (but only after the client incurs the cost of filing suit). Some real-world examples follow:

- Healthcare provider files an A.R.S. § 33-931 lien that is not properly perfected (*i.e.* fails to file timely, fails to mail the lien as per the statute). *McReynolds v. Flagstaff Med. Center*, CV 82004-0298, Yavapai County (claim withdrawn after filing suit).

- Healthcare provider claims an A.R.S. § 33-931 lien against first-party benefits or refuses to honor an attorney fee reduction.

- ERISA insurer, who is not self-insured, claims a lien against a tort recovery. *Fernandez v. Rawlings Co.*, CV2004-020323, Maricopa County (claim withdrawn after filing suit).

- Healthcare providers claim lien after being paid by health-insurance, which prohibits balance billing. *Allen v. AZ Bone & Joint Spec.*, CV2005-004815, Maricopa County (claim withdrawn after filing suit).

- Healthcare provider claims an A.R.S. § 33-931 lien after accepting Medicare or AHCCCS payment. *Sims v. Banner Health, CV-01131, USDC* (claim withdrawn after filing suit).

- Workers' compensation carrier claims a lien to recovery without any allowance for attorney's fees.

- Chiropractor claims a lien simply based upon having sent "records and bills" from accident-related treatment.

- Third-party administrator claims an ERISA lien against a tort recovery

of a church or government employee.

- ERISA insurer initially claims a lien in writing, then agrees orally that, while they actually have no valid lien rights, they will not "put it in writing."

This is a small sample of the unpleasant problems that Petitioner's members confront. These of problems are real and, unfortunately, ever-increasing. That is why this Petition has become necessary and why there is a swell of support from those filing favorable comments in connection with Petition No. R-11-0024.

2. The proposed amendment's purpose is restoring balance between a property-possessing lawyer's competing ethical obligations to the lawyer's client and to a third party claiming a right to some or all of the client's property in the lawyer's possession.

When a lawyer holds funds belonging to a client, and a third party makes a claim against those funds, competing commitments arise between the lawyer's duty to the client and the lawyer's duty to the third-party claimant. But placing 100% of the burden on an alleged debtor's lawyer to unilaterally freeze the property of the lawyer's client—and to initiate litigation to test the validity of the third-party claim—is unprecedented in relations between debtors and creditors. In no other context are funds non-judicially frozen by a creditor's mere assertion of a right to the funds.

This Petition seeks a just balance. Like Petition No. R-11-0024, this Petition asks the Court to adopt a reasonable way to shift the burden to the

third-party claimants to prosecute their actual or alleged claims to property in the lawyer's possession. This Petition still imposes burdens on lawyers who possess property, but alters the lawyer's ethical obligation when the lawyer serves direct notice on the third party and—after a reasonable, specific time—the third party fails to act.

The proposed amendment will only apply when there is a dispute between a client and the third party over the third party's interest in property in the lawyer's possession. The proposed amendment will prevent a third party from using the ethical rules to indefinitely freeze the client's property without due process of law and will prevent the third party from trying to transform the client's lawyer into the third party's de facto collections agency.

As presently worded, ER 1.15 and Comment 4 circumvent the detailed protections of the substantive writ-of-attachment process without offering anything in their place. That violation of due process of law is bad enough. In addition, the present wording of ER 1.15 and Comment 4 unfairly interposes a third-party's interests into an otherwise conflict-free attorney-client relationship. The proposed change restores the attorney-client balance. After the change, people hiring lawyers who obtained property for them will no longer be dramatically worse off than people who obtained the same property without a lawyer's help.

3. The State Bar has added duties to ER 1.15 that neither it nor Comment 4 contain.

The problem with the existing version of ER 1.15 goes beyond the text of the Rule and Comments and extends to ethical opinions that—with the best of intentions—unintentionally expanded a lawyer's obligations. Those ethical opinions have added duties to ER 1.15 that do not appear in its text or in its Comment 4. In that regard, the main difficulty is Ethics Opinion 98-06, which addresses a lawyer's obligations to a medical-care provider claiming an interest in personal-injury-settlement funds that a personal-injury client's lawyer is holding. Ethical Opinion 98-06 concludes that, if the lawyer has actual knowledge about the third party's interest in the funds, the lawyer has a number of duties:

- The lawyer must promptly notify the third party about the funds.
- The lawyer must promptly deliver to the client only those funds that the client is entitled to receive.
- The lawyer must promptly deliver to the third party only those funds that the third party is entitled to receive.
- When the lawyer has any good-faith doubt about who is entitled to receive any "disputed funds," the lawyer must:

    (1) Notify the third party—presumably about the lawyer's good-faith doubt.

    (2) Investigate the third-party claim with reasonable diligence, promptness, and competence.

(3) Hold only the disputed funds in trust pending resolution of the dispute.

(4) Resolve the dispute by negotiation, arbitration, or, if necessary, by filing an interpleader action.

The "good-faith doubt" duties that Ethical Opinion 98-06 imposes on a lawyer are especially worrisome. In that form—or at all—those duties do not appear in ER 1.15 or in its Comment 4. Moreover, the duties imposed under Ethical Opinion 98-06 create more questions than they answer. For instance, who is to say whether the lawyer has conducted an investigation of the third-party's claim with reasonable diligence, promptness, and competence? If the client or third party is dissatisfied, one or the other, or both, will assert that the lawyer's investigation was neither diligent, nor prompt, nor competent.

The final resolving-the-dispute section of Ethical Opinion 98-06 is even more troubling. If arbitration is unacceptable or unproductive, the funds remain in limbo. The only alternative is filing an interpleader action, although the present version of ER 1.15 imposes no deadline for doing that. Even more important for the client, an interpleader action is an unpleasant surprise, since the client's own lawyer is thrusting the client into collateral litigation costing time, effort, anxiety, and money. Presumably, the client must pay to file the interpleader action, pay for service of the summons and complaint on the claimant or claimants, and pay for legal representation.

If the proposed amendment is implemented, the initial costs of any judicial claim-enforcement action will fall on the claimant, the party seeking to take all or part of property in the lawyer's possession. A 90-day clock begins to run as soon as the lawyer has made direct service—by process server— on the claimant. The claim against the property that the lawyer is holding for the client will no longer remain frozen. Claims that a claimant regards as so small that no judicial action is justifiable will go wherever de minimis claims go. Claims that are significant enough to warrant judicial action will receive the judicial attention they deserve. The proposed amendment is a fair method for ending gridlock and resolving claims fairly, efficiently, and economically.

4. The proposed amendment does not alter any substantive right.

The proposal to amend ER 1.15(e) does not alter—and cannot alter—any substantive rights that a third party enjoys against a client or the client's lawyer. Paragraph 20 to Arizona Supreme Court Rule 42 explains that the Ethical Rules "are designed to provide guidance to lawyers and to provide a structure for regulating conduct through disciplinary agencies. They are not designed to be a basis for civil liability."

Some have suggested that changing ER 1.15(e), or changing Comment 4, alters substantive law. But ER 1.15 has nothing to do with substantive

rights. Nonetheless, to be sure, the final sentence in the proposed amendment explicitly states that, "Nothing in this rule is intended to release a lawyer from any liability related to disbursing property or otherwise alter a third party's substantive rights." A third party with substantive rights has an unaltered ability to enforce those substantive rights through proper legal action, such as by filing a lawsuit or seeking a writ of attachment.

Conclusion

Petitioners respectfully ask the Court to amend Ethical Rule 1.15 ("Safeguarding Property") of Rule 42, Arizona Rules of the Supreme Court.

DATED this 17th day of August, 2012.

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Certificate of Service

On the above date, counsel for the Petitioner electronically filed the original of this document in Word and pdf formats with the Clerk of the Court, Arizona Supreme Court.

Exhibit 1

Proposed Amendment to
Ethical Rule 1.15 ("Safeguarding Property") of
Rule 42, Arizona Rules of the Supreme Court

(Additions are shown underlined and deletions are shown ~~stricken~~.)

(e) When in the course of representation a lawyer possesses 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~~ any portion~~s~~ of the property as to which ~~the interests are not in dispute~~ there are no competing claims. Any other property shall be kept separate until one of the following occurs:

(1) the parties reach an agreement on the property's distribution;

(2) a court order resolves the competing claims; or

(3) where the competing interests are between a client and a third-party, the lawyer holding the property provides written notice by personal service under the Arizona rules of civil procedure to the third-party notifying it that it must either file an action within 90 calendar days of the date of service or the property held by the lawyer will be released to the client.

If the lawyer is notified in writing of an action filed within the 90-day period, the lawyer shall continue to hold the property separate unless and until (1) the parties reach an agreement on distribution of the property or (2) a court resolves the matter.

Nothing in this rule is intended to release a lawyer from any liability related to disbursing property or otherwise alter a third party's substantive rights.