

# FEATURE ARTICLE



## Attorney Misappropriation Of Client Funds: Approaches Toward A Solution

by Kate G. Turnbull\*

### Introduction

For a variety of reasons, public opinion of the legal profession as a whole is less than favorable. While the negative attitude toward attorneys may be actually justified by only an occasional instance of serious misconduct, the issue of poor public image is one all members of the profession must address.

Perhaps one of the most damaging—but unfortunately pervasive—stereotypes is of the attorney as thief or “shyster.” Attorneys hold assets belonging to their clients in a variety of contexts: settlements from lawsuits, funds collected by the attorney on behalf of the client, real estate deposits held in escrow, fines to be paid on the client’s behalf, advances for costs, and prepaid legal fees for specific services yet to be performed by the attorney. Rule 1.15 of the American Bar Association (ABA) Model Rules of Professional Conduct<sup>1</sup> requires that any funds belonging to a client be maintained in a separate bank account apart from funds belonging to a lawyer or his firm. The same rule also requires the attorney to maintain complete records of all clients’ funds, render an accounting to clients as to their funds, and promptly pay clients all funds in the lawyer’s possession which are due them.

Breaches of professional ethics in handling clients’ funds occur in a variety of circumstances. An attorney’s failure to establish a separate bank account for clients’ funds and the resulting commingling of a lawyer’s funds with those of her client constitute grounds for discipline, although such a violation of Rule 1.15 is not necessarily an indication of illegal intentions or future misappropriation.<sup>2</sup> Frequently, commingling is combined with inadequate bookkeeping, which precludes the attorney from determining whether he is spending his own money or that of his clients.<sup>3</sup> The

consequence is often misappropriation, which began as careless and unintentional conduct but gradually evolved into embezzlement as the “borrowing” continued and increased in amount.<sup>4</sup> On the other hand, many other cases of misappropriation unfortunately involve attorneys who deliberately steal from their clients.

The legal profession’s response to the problem of attorney misappropriation traditionally has been limited to establishing and enforcing standards for admission to and expulsion from the bar. Within the past 25 years, however, almost every state has established a client security fund (CSF),<sup>5</sup> either by promulgation of court rules or through the actions of state bar associations, in order to provide a mechanism for compensating clients injured through attorney dishonesty. Subject to maximum dollar limitations for any single award,<sup>6</sup> the CSF reimburses defrauded clients presenting eligible claims.

The first part of this article describes the general operation and administration of a client security fund, using California’s CSF as an illustrative example. The second section discusses the public policies underlying the creation of CSFs, and critiques the actual performance of CSFs in achieving articulated policy goals. The conclusion makes recommendations for reform and suggests areas for further exploration.

### The Client Security Fund

The CSF is a means by which members of the legal profession contribute their own money to reimburse clients injured by the dishonest actions of their lawyers. Many CSFs, financed by appropriations from general bar dues, receive either a fixed annual contribution from the bar or an amount which varies from year to year depending on the degree to which the fund has been depleted by awards to clients.<sup>7</sup>

Commissioners or trustees appointed by the state supreme court or the state bar administer the CSF’s operations. The trustees are authorized to manage

and invest the assets of the fund, evaluate the claims of aggrieved clients, make awards, enforce claims for restitution arising by subrogation or assignment, file written and financial reports, and hire consultants, legal counsel, and other employees.<sup>8</sup> Generally, the trustees are vested with exclusive and unreviewable authority in performing their primary task, which is to determine whether a claim merits reimbursement, and if so, the proper amount of reimbursement.<sup>9</sup>

*California’s CSF: A Case Study.* The notion of a program funded by attorneys to compensate clients injured by the misconduct of fellow attorneys was first implemented in 1929 in New Zealand.<sup>10</sup> The first states in this country to adopt the idea were Vermont and Oregon in 1958. By 1971—the time the California State Bar successfully sought legislation empowering it to create a CSF, thirty-three other state bars and twenty-one local bar associations already had CSFs in operation.<sup>11</sup>

The proposal to establish a CSF in California was not readily accepted. Critics of the fund made the following arguments:

-The legal profession may have an obligation to the general public, but this obligation is performed more effectively by carefully screening admissions to the bar and vigorously disciplining misconduct. Indemnity is not required.<sup>12</sup>

-The plan could worsen public relations and increase the problems now confronting the Bar and its members in their relations with the public.<sup>13</sup>

-Adoption of a CSF would be, in the eyes of the public, official recognition of the fact that the legal profession is so corrupt that it must assess itself to indemnify the public against the misconduct of its members.<sup>14</sup>

-The adoption of such a plan would unjustifiably encourage and increase charges of dishonesty against members of the bar and charges of malpractice based upon claims of simple negligence.<sup>15</sup>

-The small number of misappropriations

\*The author is a 1988 graduate of the University of San Diego School of Law and a former intern at the school’s Center for Public Interest Law.



tion cases each year does not warrant a remedy of this magnitude and cost.<sup>16</sup>

-Attorneys would be encouraged to be lax in their dealings with clients' funds, knowing that any loss would be made up by the fund.<sup>17</sup>

-The fund is unable to fully compensate all wronged clients. The disappointment engendered by this fact may outweigh any gains in the area of public relations.<sup>18</sup>

-The plan is socialistic.<sup>19</sup>

While some of these arguments may have merit, in 1971 the proponents of the CSF succeeded in passing legislation authorizing creation of California's CSF. For seventeen years, section 6140.5 of the Business and Professions Code has stated that the State Bar "may establish and administer a Client Security Fund to relieve or mitigate pecuniary losses caused by the dishonest conduct of the active members of the State Bar. Any payments from the fund shall be discretionary and shall be subject to such regulation and conditions as the board shall prescribe."<sup>20</sup> The Board of Governors was also authorized to delegate the fund's administration to the State Bar Court or any other board or committee which it might create. The following year, the Board of Governors created the Client Security Fund Commission to administer the fund, and promulgated rules for the administration of the CSF.<sup>21</sup> The Commission is composed of seven members: four attorneys and three public members. Members of the Commission are appointed by the Board and serve at the pleasure of the Board.

California's CSF is very similar to funds found in other states. With respect to funding and administration, California has the advantage of having an integrated bar with a large membership and a centralized disciplinary system already established. Currently, all active members of the Bar are required to pay \$25 annually toward the CSF.<sup>22</sup>

Under the procedures set forth by the Board, an eligible claimant must file an application for reimbursement. In order to do this, applicants must be aware of the existence of the CSF. Prior to 1988, individuals who filed disciplinary complaints against attorneys were not routinely notified of the existence, scope, and reimbursement policies of the CSF. A public outreach program has been proposed, but is "not a priority" at this point.<sup>23</sup>

Specific classes of individuals are excluded from eligibility for CSF com-

penation at the outset. For example, relatives, associates and employees of the attorney; insurers, bonding agencies, and other companies seeking reimbursement under an insurance or surety contract covering the risk involved in the lawyer's misconduct; any business entity controlled by the lawyer; and government agencies are all ineligible.<sup>24</sup>

In addition, the attorney causing the loss must have been acting as an attorney; in a fiduciary capacity "customary to the practice of law"; or as an escrow holder or other fiduciary.<sup>25</sup> The current status of the attorney *qua* attorney is also essential. Reimbursement requires that one of the following events have occurred: the lawyer must be dead, mentally incompetent, disciplined, resigned from the practice of law, judged guilty of a crime, or a judgment debtor of the applicant.<sup>26</sup>

In order for the claim to be compensable, the applicant must show that she has suffered a "reimbursable loss."<sup>27</sup> Thus, it must be shown that the money or property which was allegedly misappropriated "came into the hands" of an active member of the State Bar while acting as a lawyer, trustee, or fiduciary, and that the loss was caused by the dishonest conduct of the attorney.<sup>28</sup> "Dishonest conduct" includes theft or embezzlement of money or the wrongful conversion of money or property; refusal to return unearned fees; borrowing money from a client without any intention of repaying it; or any act of intentional dishonesty which proximately leads to the loss of money or property.<sup>29</sup>

After filing, each application is screened by counsel.<sup>30</sup> During this process, the Commission or its counsel may have access to State Bar disciplinary records which have not become public.<sup>31</sup> The application may be investigated by CSF staff counsel or referred to the State Bar Offices of Investigations or Trial Counsel for investigation in connection with a pending disciplinary matter.<sup>32</sup> When a CSF claim involves an attorney who is the respondent in a pending disciplinary proceeding, a referee of the State Bar Court may order the two actions consolidated for hearing before the same hearing panel.<sup>33</sup> The Commission itself has the authority to take and hear evidence, and compel the attendance of witnesses and the production of documents. Neither the claimant nor the attorney has a right to appear before the Commission, although either party may request to appear.<sup>34</sup>

After the initial screening and investi-

gation, the Commission tentatively decides what action should be taken on the application, including possible referral to the State Bar Court for an evidentiary hearing. The tentative decision is served on the applicant and the lawyer involved, and each is given thirty days to file objections to the proposed action.<sup>35</sup> The Commission (or the State Bar Court, if the claim is referred there for evidentiary hearing) may "take whatever action it deems appropriate,"<sup>36</sup> including reimbursement from the fund, denial of reimbursement, or referral to the State Bar Court if the Commission concludes this is necessary. The Commission's decision may be made with or without prejudice to the applicant presenting a further application,<sup>37</sup> and (except for applications referred to the State Bar Court) constitutes the final action of the State Bar.<sup>38</sup> The Commission and the State Bar Court may postpone consideration of an application until after disciplinary action or any pending or contemplated court proceeding has been completed.<sup>39</sup> The final decision of the Commission or the State Bar Court may be reviewed by the applicant in superior court.<sup>40</sup>

This entire process—from receipt of a claim by the CSF to final decision by the Commission—takes an average of 2.3 years in California.<sup>41</sup> The average lag time between a loss and the filing of a CSF claim is 3.4 years.<sup>42</sup> Thus, in California, it takes the State Bar almost six years to complete a disciplinary proceeding and process a CSF claim.

For an idea of the size of the CSF in California, consider the following 1986 statistics. The staff assigned to the fund consists of one director, two attorneys, two secretaries, one investigator, and one records coordinator.<sup>43</sup> In 1986, the Fund received \$885,900 through assessments on 88,590 active attorneys,<sup>44</sup> \$71,552 through investment of fund assets, and \$20,500 was recovered through subrogation.<sup>45</sup> Four hundred and sixty-seven claims were received, totalling \$6.9 million in claims. The fund paid 138 claims in 1986, including 81 claims paid in full.<sup>46</sup> The total dollar amount of these paid claims was \$830,000. Historically, the average claim amount has been \$9,967, and the average claim paid has been \$7,699.<sup>47</sup> The ratio of payments to claims amounts for 1983 to 1985 filings was 49%.<sup>48</sup> The CSF started 1987 with 844 claims outstanding, totalling \$8,911,104.65. Five hundred sixty-seven new claims were opened, seven closed claims were reopened, and 380 were closed. Thus, at



the conclusion of 1987, there were 1,035 open claims and a projected \$2,849,266 in revenues.<sup>49</sup>

## Policy Justifications: Are They Achieved?

Two objectives or justifications are commonly cited as the basis for creating CSFs. The first objective is based on the belief that the profession as a whole owes defrauded clients a "debt of honor."<sup>50</sup> The profession represents its members to the public as "honorable, learned and skilled," and "when this trust is betrayed, the profession as a whole has a duty to rectify the wrong committed against a client."<sup>51</sup> According to the California State Bar, the establishment of CSFs furthers the legal profession's role as a "public profession devoted to serving the public" for whom the "spirit of public service" acts as its motivating force.<sup>52</sup> The client has "relied on the profession's collective representation"<sup>53</sup> and the profession has an obligation to remedy the losses stemming from such reliance.

A number of commentators have contended, however, that only full reimbursement of all clients' losses can totally repay the professional debt of honor.<sup>54</sup> For these critics judging the success of existing funds in satisfying this objective, the extent to which the funds have reached the goal of full reimbursement serves as the primary criterion. Three aspects generally common to the funds have limited their ability to attain the objective of full reimbursement: lack of publicity; dollar limitations on the amount of recovery; and stringent eligibility criteria.

Many funds are deficient in publicizing their activities. Since clients will present claims for reimbursement only if they are aware of the existence of a CSF, publicity about a fund is essential. Most states report that their funds are publicized through "word of mouth", brochures, periodic news releases, and local bar associations; few describe an organized and aggressive public relations program for their CSFs.<sup>55</sup> One disincentive to an aggressive publicity campaign is a low level of revenues in most funds. Why publicize a program which cannot satisfy its objectives?<sup>56</sup> State bars are also hesitant to openly publicize their CSFs because the publicity that is essential to a public understanding of the CSF necessarily entails the revelation of attorney misconduct. Public recognition of professional efforts at reimbursement will be accompanied by a greater awareness of the extent of

attorney misappropriation.

In addition to inadequate publicity, express dollar limitations on the awards of many CSFs also contribute to the failure of many funds to repay in full the collective "debt of honor" of the profession.<sup>57</sup> Maintaining the solvency of the CSF may necessitate payment of only a portion of the claimed amount of the loss.<sup>58</sup> The client has no recourse in such a case because CSF awards are made as a matter of grace and not as a matter of right.<sup>59</sup>

Several explanations have been advanced in support of broad CSF discretion in determining the amount of awards and the dollar limitations on awards to eligible claimants. Rules granting discretion to CSF trustees have been justified by the unavailability of data concerning attorney misappropriations, which prevents the trustees from accurately estimating the volume and magnitude of future claims and requires the trustees to exercise restraint in making awards.<sup>60</sup> It has also been argued that the dollar limitations of CSFs are analogous to the maximum awards payable by the Federal Deposit Insurance Corporation to depositors.<sup>61</sup> Finally, dollar limitations are defended as temporary provisions to protect new funds from being "bankrupted" by large claims.<sup>62</sup>

The stringent criteria which a claimant must satisfy to be eligible for an award constitute a third limitation on the capacity of present CSFs to provide full reimbursement. All CSFs limit their reimbursements to losses attributable to intentional attorney misconduct and do not reimburse losses due to attorney negligence.<sup>63</sup> However, it is difficult to distinguish between malpractice and intentional theft in cases where the client has paid an advance fee for particular services, and the attorney subsequently performs few, if any, services while retaining all or most of the money. A number of funds reimburse a client where no services have been performed and the retainer has been kept by the attorney.<sup>64</sup> Partial performance of services, however, may preclude reimbursement from the CSF for the losses, thus relegating the client to an entirely separate set of procedures established by most bars to arbitrate fee disputes.

Another significant limitation on awards from the funds is that the loss must have been suffered in a transaction occurring within the "attorney-client relationship." For instance, the profession does not recognize any obligation to indemnify losses attributable to a

lawyer when he has defaulted on a loan from a client or has acted as a business partner or investment counselor for the client, rather than as an attorney.<sup>65</sup> Some funds also deny claims resulting from an attorney's actions in the capacity of an executor, trustee, guardian, or other kind of fiduciary, provided the attorney was not acting in her professional capacity as a lawyer.<sup>66</sup>

Finally, many funds require that a client exhaust his legal remedies against an attorney before he is eligible for an award. These legal remedies may include criminal conviction or successful completion of disciplinary proceedings against the offending attorney.<sup>67</sup> This requirement ensures that either a court or disciplinary agency will determine whether a client's losses were caused by a lawyer's dishonest conduct in his capacity as an attorney, saving the trustees from making such a determination. However, this also subjects a claimant to a prolonged delay until final court action (including appeal) is completed, which may encourage the client to seek a private settlement instead of filing a complaint with the state bar disciplinary agency and applying to the fund for compensation.

Some funds do not require that a client first sue to recover his money, but require that a claimant enter into a subrogation agreement with the fund, assigning his rights against the defaulting attorney to the trustees of the fund.<sup>68</sup>

A second goal of CSFs arises from the fact that the legal profession is essentially a self-regulated one. This justification assumes that the public will view the suspension or disbarment of an offending attorney after a misappropriation has occurred as an inadequate response by the profession because these sanctions do not provide restitution to the client, and the losses of the client are seldom reimbursed by the attorney.<sup>69</sup> Thus, the organized bar views the CSF as a means of accommodating the public demand for accountability, while quelling public dissatisfaction and preserving the freedom of the profession to regulate itself without intervention. It is not clear whether the funds have succeeded in lessening public dissatisfaction with the legal profession's self-regulation.<sup>70</sup>

## Recommendations for Change

Primarily, it is critical to recognize that client security funds—no matter how well-publicized or successful—cannot substitute for effective regulation. Payment from such funds will neither deter attorney misconduct nor rid the



profession or dishonest practitioners. The funds can only complement the actions of the bar's admissions screening, post-admissions requirements, and its disciplinary agency, to remedy the injuries of clients which could not be prevented by the bar's efforts at regulation. If the legal profession is to remain a self-regulated one, then state bar associations and state legislatures must work together to ensure that a comprehensive, effective regulatory system is maintained.<sup>71</sup>

Conversely, the failure of CSFs to achieve the goals justifying their creation can result in a breakdown of the attorney discipline system, which relies heavily on consumer complaints as its primary source of information. A CSF process which appears lengthy, cumbersome, and potentially unrewarding discourages consumer participation or use, and in fact encourages the possibility of privatizing the dispute between the client and attorney. In order to maximize the opportunity for restitution, an aggrieved client or an attorney subsequently retained to represent the client may seek a private settlement with the offending attorney rather than filing a disciplinary charge.<sup>72</sup> Even where there is the possibility of an award from a CSF, the client may still seek a private settlement.

A decision by clients to seek private settlement rather than to file a disciplinary complaint weakens the scope and efficiency of professional discipline by failing to prevent or deter the misappropriating attorney from engaging in further embezzlements. Moreover, the pressure on the attorney to make restitution to a complaining client in order to avoid disciplinary penalties may jeopardize the monies of other clients of the attorney. Private settlement without reporting thus undermines the profession's efforts to discipline misappropriating attorneys.<sup>73</sup>

Thus, it appears that the legal profession needs CSFs—to compensate victims of attorney dishonesty and preserve the integrity of the profession in the eyes of the public, and because professional malpractice insurance (even where required) does not generally cover intentional acts. And, the CSFs must be truly responsive to consumer needs, or they will partially contribute to a breakdown of the attorney discipline system. Strengthening the profession's response to attorney misappropriation may be accomplished in two general areas.

*Prevention.* A number of states, particularly those with mandatory continu-

ing legal education requirements, sponsor educational programs on recordkeeping, law office management, and legal ethics.<sup>74</sup> As a preventive measure, such programs assume that the misappropriation of funds is the result of poor recordkeeping or, at worst, negligence. To the extent that the misconduct is not intentional, educational programs may be valuable; at the very least, they will put attorneys on notice regarding the minimum recordkeeping required of them.

Rule 1.15 of the Model Rules of Professional Conduct requires an attorney to keep "complete records" of all funds received from clients. Several states have elaborated on this requirement by promulgating detailed descriptions of the kinds of records and bookkeeping procedures which constitute "complete records." While each jurisdiction has established different requirements, the policies behind the requirements are similar. First, a clear explanation of precisely what is required of an attorney in terms of bookkeeping may have a deterrent effect. Second, a thorough recordkeeping requirement could prove invaluable to disciplinary investigations into complaints of misappropriation.

Any deterrent effect of requiring detailed bookkeeping could be greatly enhanced by a system of random audits of client trust accounts. Six states conduct such audits and five more are considering the idea.<sup>75</sup> A program of audits combined with a useful set of accounting guidelines could provide disorganized attorneys with the motivation and the means to maintain adequate records. In addition, the threat of an audit may deter an attorney considering an unauthorized "loan" from a client account. Finally, an audit could detect cases of intentional misappropriation before the client trust accounts have been substantially depleted.

Overdraft notification is another means by which "negligent" attorneys may be made aware of a recordkeeping problem before it becomes unmanageable. Four states currently have overdraft notification programs, and an additional eight states have the idea under consideration.<sup>76</sup> The ABA's Standing Committee on Clients' Security Funds has been monitoring the utility of both random audits and overdraft notification. Apparently, the states with such programs find them to be effective, for the Committee is considering the inclusion of both random audits and overdraft notification in the ABA's revised Model Rules for Clients' Security

Funds.<sup>77</sup>

*Administration of CSFs.* Many CSFs, including California's, appear to be plagued by insufficient funds, lack of publicity, and unacceptable delays in processing claims.

If any fund is going to serve the dual functions of providing restitution to clients and protecting the integrity of the legal profession, it must have adequate funds. Implementing a CSF but failing to actually pay claims because of insufficient revenues creates a very negative image in the public eye. Some CSFs have been relatively effective in raising funds. Almost all CSFs assess attorneys licensed to practice in the state. Nine states receive a budget appropriation in addition to assessment revenues.<sup>78</sup> Such a combination of resources not only enhances fund reserves, but reflects favorably on the entity making the appropriation.

One source of revenue which the states have utilized to varying degrees is the offending attorney. Ensuring restitution may be accomplished either through the discipline imposed, or through actions brought subsequent to the disciplinary proceeding. For example, New Jersey reports that in most cases the discipline imposed for misappropriation is disbarment. However, in those cases where the respondent is not disbarred, restitution is always ordered as a condition of full reinstatement. In addition, the CSF files suit against any respondent on whose account the fund has paid claims.<sup>79</sup> Finally, the New Jersey CSF pursues third-party collateral sources, such as title insurance and depository banks in forged endorsement cases.<sup>80</sup> With the cooperation of state legislatures, CSFs could assume the position of a creditor, and restitution to the fund could become a priority payment like child support payments and tax liabilities.<sup>81</sup>

Next, CSFs must adequately publicize their existence, scope, and procedures. Most state bar discipline agencies assign a code or otherwise categorize consumer complaints according to the type of attorney misconduct alleged; it would not be difficult to mail an informative brochure to all clients complaining of misappropriation upon receipt of the complaint.<sup>82</sup> Such a publicity program would not appreciably increase the general public awareness of attorney misconduct; complaining witnesses are already keenly aware of it.

The processing time for claims is another area where improvement is needed in many states. As noted, Cali-



ifornia's *average* processing time is 2.3 years,<sup>83</sup> because of its general policy of waiting until discipline is imposed on an attorney before considering CSF reimbursement. A significant amount of time could be saved by consolidating appropriate CSF claims with a concurrent disciplinary proceeding. California's CSF Rules of Procedure provide for this, but such a time-saving measure has not been recently utilized.<sup>84</sup> To the extent that this delay is also attributable to insufficient staffing of CSFs, state bar disciplinary agencies should closely examine their CSF workloads and case backlogs, and provide adequate staff resources.<sup>85</sup>

### Conclusion

Client security funds, by compensating for the losses of clients that the disciplinary system and malpractice insurance fail to address, complement traditional efforts at self-regulation. The funds, however, are strictly remedial and not preventive. If the legal profession intends to remain a self-regulated profession, attorneys, state bar associations and state legislatures must work together to effectively prevent attorney misconduct.

It also appears clear that state bars should focus more attention and resources on creating properly-functioning, responsive CSFs. The CSF is the last resort for innocent client-victims who are truly deserving of recompense. Neither these victims nor CSFs should be treated as the forgotten stepchildren of the attorney discipline system.

### FOOTNOTES

1. The ABA Model Rules have been adopted in whole or in part by 28 states, and are under consideration in others.

2. Once the clients' funds have been commingled with those of the attorney, there is an increased danger that the clients' money will be used for the attorneys' personal expenses or subjected to the claims of her creditors. "The rule against commingling was adopted to provide against the probability in some cases, the possibility in most cases, and the danger in all cases that such commingling will result in the loss of the clients' money." *Black v. State Bar*, 57 Cal. 2d 219, 225-26, 368 P.2d 118, 122, 18 Cal. Rptr. 518, 522 (1962).

3. See, e.g., *Florida Bar v. Loveland*, 249 So.2d 19 (Fla. 1971).

4. Carpenter, *The Negligent Attorney Embezzler: Delaware's Solution*, 61 A.B.A.J. 338 (1975).

5. At the end of 1987, only Maine

and New Mexico did not have active CSFs. Kansas and Alabama established funds in 1987, and Tennessee's fund is inactive but under review. *1987 Client's Security Fund Survey*, American Bar Association Center for Professional Responsibility (hereinafter cited as "CSF Survey") at 1.

6. See *infra* text at notes 57-62.

7. Most CSFs assess all active members of the bar on an annual basis. Assessments range from \$2 (Indiana) to \$100 for attorneys admitted to the bar for more than ten years (Delaware). In addition, eleven funds receive budget appropriations from the state bar association or the state supreme court. CSF Survey, *supra* note 5, at 7-13.

8. Atkins and Kane, *Clients' Security Fund Maintains Bar's Integrity*, 44 Fla. B.J. 130 (1970).

9. Only ten states (including California) provide an appeal process, usually to a state court; in one state, claimants may appeal to the Board of Governors of the State Bar (Colorado). CSF Survey, *supra* note 5, at 14-17.

10. For a brief but interesting history of the international development of CSFs, see Sterling, *The Argument for a Clients' Security Fund*, 33 Cal. St. B.J. 957 (1961).

11. Bryan, *Clients' Security Fund Ten Years Later*, 55 A.B.A.J. 757 (1969).

12. McKnight, *The Argument Against Clients' Security Fund*, 36 Cal. St. B.J. 963 (1961). (Mr. McKnight was a member of the State Bar Committee on the Client Security Fund.)

13. *Id.* at 964.

14. *Id.*

15. *Id.* at 966-67.

16. Sterling, *supra* note 10, at 959-60.

17. Hunter, *The Clients' Security Fund—What Shall We Do About It?*, 38 J.B. Ass'n Kan. 23, 25 (1961).

18. Sterling, *supra* note 10, at 960.

19. *Contra* Sterling, *supra* note 10, at 960 ("[t]his argument has been made against every worthwhile cooperative effort that the bar has made in the past 25 years. The same assertion has been made against Legal Aid and the Lawyer Referral Service. The idea of a clients' security fund is no more socialistic than workmen's compensation or any other group indemnification plan.")

20. This section has been recently amended by Senate Bill 1498 (Presley) (Chapter 1159, Statutes of 1988), to require the Bar to establish the CSF.

21. State Bar of California Rules of Procedure (Client Security Fund Matters) (hereinafter referred to as "CSF

Rules of Procedure").

22. Business and Professions Code section 6140.5(b).

23. Interview with Kiyoko Tatsui, Director, California State Bar Client Security Fund, April 15, 1988 (hereinafter referred to as "Tatsui Interview").

In a subsequent letter from Tatsui to State Bar Discipline Monitor Robert C. Fellmeth dated August 12, 1988, the CSF Director amplified the Commission's plans for publicizing the CSF: "Inadequate publicity is an issue that the Commission has been working on. The Commission has recently begun releasing press releases on claims that have been paid and it has authorized the use of informational sheets about the fund to be given to all prospective complaining witnesses. A final draft has been completed and we will be working on format and typesetting the end of this month."

24. Rule 7, CSF Rules of Procedure.

25. Rule 9(a), CSF Rules of Procedure.

26. Rule 9(b), CSF Rules of Procedure. Under Rule 9(b)(2), the Commission has discretion to waive these requirements.

27. Rule 15(e), CSF Rules of Procedure.

28. Rule 2, CSF Rules of Procedure.

29. Rule 6(a)-(d), CSF Rules of Procedure.

30. The screening which occurs at this point is intended to ensure that the claim is eligible under Rules 2, 6, 9(a), and 9(b). Tatsui Interview, *supra* note 23. CSFs in 39 states evaluate claims against such an established list of criteria.

31. Rule 20(d), CSF Rules of Procedure.

32. Rule 14(b), CSF Rules of Procedure.

33. Rule 16(b)(2), CSF Rules of Procedure. Consolidation has not occurred in any post-1986 cases. In most cases, the CSF Commissioners prefer to evaluate and hear CSF claims themselves, rather than referring them to an entity of the State Bar discipline system. Tatsui Interview, *supra* note 23.

34. Tatsui Interview, *supra* note 23.

35. Rule 14(c), CSF Rules of Procedure.

36. Rule 15(b), CSF Rules of Procedure.

37. *Id.*

38. Rule 15(c), CSF Rules of Procedure.

39. Rule 15(d), CSF Rules of Procedure.

40. Rule 17, CSF Rules of Procedure.



41. CSF Survey, *supra* note 5, at 21-24. The reported average times for CSF claims processing ranges from thirty days (North Dakota) to 2.3 years (California). *Id.*

42. Robert J. Finger/William M. Mercer-Future Cost Analysts, Inc., *State Bar of California Client Security Fund Actuarial Study As Of December 31, 1986* (June 18, 1987) at 6 (hereinafter cited as "CSF Actuarial Study").

43. CSF Survey, *supra* note 5, at 2-6.

44. In 1986, the assessment in California was \$10 per active attorney. CSF Survey, *supra* note 5, at 7-10. Currently, all active attorneys contribute \$25 toward the CSF.

45. CSF Survey, *supra* note 5, at 11-13.

46. *Id.* at 18-20.

47. Dresslar, *Bar Warns Fund for Client Security Needs Money*, *Staff, L.A. Daily J.*, Dec. 4, 1987, at 1.

48. CSF Actuarial Study, *supra* note 42, at 6.

49. Tatsui, 1988 Supplemental Budget for the Client Security Fund (memorandum to the Board of Governors' Committee on Discipline) (Jan. 8, 1988).

50. Smith, *The Clients' Security Fund: A Debt of Honor Owed by the Profession*, 44 *A.B.A.J.* 125 (1958); Voorhes, *Clients' Security Fund in 1961: A Progress Report*, 47 *A.B.A.J.* 494 (1961).

51. Note, *The Disenchanted Client v. The Dishonest Lawyer: Where Does the Legal Profession Stand?*, 42 *Notre Dame Law.* 382, 385 (1967).

52. Resolution by the Board of Governors of the State Bar of California Establishing a Client Security Fund (June 17, 1971).

53. *Id.*

54. Amster, *Clients' Security Funds: The New Jersey Story*, 62 *A.B.A.J.* 1610, 1613 (1976); Atkins and Kane, *supra* note 8, at 132.

55. CSF Survey, *supra* note 5, at 25-29.

56. Interview with Gilbert Webb, ABA Center for Professional Responsibility (April 15, 1988) (hereinafter referred to as "Webb Interview").

57. Maximum payments per claim range from \$5,000 (six states) to \$100,000 (New York). A few states report no limit on payment per claim, and others state the maximum payment in terms of a percentage; e.g., 10% of fund balance in any year. CSF Survey, *supra* note 5, at 25-29.

The maximum allowable payment in California is \$50,000 if the loss occurred

after January 1, 1982, and \$25,000 for losses which occurred after March 4, 1972 and before January 1, 1982. Rule 4(b), CSF Rules of Procedure. Only one maximum amount is allowed, regardless of the number of losses suffered during the course of any one engagement for services. Rule 4(a), CSF Rules of Procedure.

58. Some funds have attempted to avoid this problem by establishing a percentage of the fund balance as the maximum payment. For example, the Arkansas CSF limits payment to the lesser of \$10,000 or 10% of the fund. CSF Survey, *supra* note 5, at 25-29.

59. Rule 2, CSF Rules of Procedure.

60. Webb Interview, *supra* note 56.

61. Smith, *supra* note 50, at 128.

62. *Id.*

63. It is generally believed that losses stemming from attorney negligence are best compensated through the malpractice insurance system. However, such insurance is not required in many states, and a lack of insurance plus the refusal of CSFs to consider negligence claims or compensation/reimbursement for unsatisfied civil malpractice judgments leaves the victimized client with no remedy.

64. See, e.g., Rule 6(b), CSF Rules of Procedure, which includes the following: "Refusal to refund unearned fees received in advance where the lawyer performed no services or such an insignificant portion of the service that the refusal to refund the unearned fees constitutes a wrongful taking or conversion of money."

65. Rule 10 of the CSF Rules of Procedure excludes losses occasioned by a loan or investment transaction unless it arose out of and in the course of the attorney-client relationship. The rule adopts a "but for" standard; but for the fact that the dishonest attorney enjoyed a privileged relationship with the client, the loss would not have occurred. See Rule 10(a)-(e), CSF Rules of Procedure.

66. In California, the lawyer dishonestly causing the loss must have been acting as a lawyer; in a fiduciary capacity "customary to the practice of law," such as an administrator, executor, trustee of an express trust, guardian, or conservator; or as an escrow holder or other fiduciary, having been designated as such as a result of the attorney-client relationship. Rule 9, CSF Rules of Procedure.

67. Prior discipline is required in 26 states. CSF Survey, *supra* note 5, at 34-36. In California, discipline, death, or incompetence is generally a prerequisite

to recovery, but this requirement may be waived. Rule 9(b), CSF Rules of Procedure. A few states may order restitution as part of the discipline. New Jersey reports that, in those few cases where the attorney has not been disbarred, restitution is always ordered as a condition or reinstatement. An order of restitution is also sought as part of sentencing in criminal proceedings. See CSF Survey, *supra* note 5, at 30-33.

68. Twenty-eight states, including California, require subrogation/assignment agreements prior to making payment on a claim. CSF Survey, *supra* note 5, at 30-33.

69. Reimbursement from attorneys has historically been about 4% of claims payments. CSF Actuarial Study, *supra* note 42, at 4.

70. It is very difficult to assess this point because public dissatisfaction is not easily measured and because the funds—both in character and success—differ greatly from state to state. That is, some states (such as New York) have been very aggressive in terms of public relations, while other states appear to make very little effort to increase public awareness. Webb Interview, *supra* note 56.

71. In California, the legislature created a State Bar Discipline Monitor, an independent position armed with investigatory powers, to study the State Bar's discipline system over a multi-year period, and to advocate recommendations for change both in discipline and in non-discipline areas which impact on the discipline system. See *Business and Professions Code* section 6086.9. For a condensed version of the Initial Report of the State Bar Discipline Monitor, see *California Regulatory Law Reporter* Vol. 7, No. 3 (Summer 1987) at 1.

72. Under the ABA rules, attorneys retained by clients seeking restitution from another attorney must report the offending attorney's conduct. "A lawyer having knowledge that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer in other respects, shall inform the appropriate professional authority." Rule 8.3(a), ABA Rules of Professional Conduct.

The California State Bar has considered but rejected adoption of Rule 8.3(a).

73. Section 6090.5 of the California Business and Professions Code prohibits attorneys from requiring an agreement not to report in exchange for private settlement of a misappropriation case.



The California State Bar is currently considering a proposed legislative amendment which would make it grounds for discipline for an attorney, in negotiating a settlement of a misappropriation claim, to require a client to withdraw a complaint previously filed with the State Bar, or to cease cooperating with the State Bar as a condition of settlement. Letter from Deputy Chief Trial Counsel Francis P. Bassios to State Bar Discipline Monitor Robert C. Fellmeth (Sept. 16, 1988).

74. Eighteen states report the existence of such educational programs, and a number of others are considering them. CSF Survey, *supra* note 5, at 25-29. In 1988, the California Bar approved a mandatory continuing legal education (CLE) program, which will require active members of the Bar to participate in 36 hours of accredited CLE activities over three-year periods, of which at least eight hours must be in the areas of legal ethics and law practice management. However, legislation to impose a \$5 Bar dues surcharge to cover the costs of administering the CLE program was recently defeated in the state Senate.

75. CSF Survey, *supra* note 5, at 25-29.

76. *Id.* In California, SB 1498 now requires banks to notify the State Bar whenever an NSF check is written on a client trust fund account. *See supra* note 20.

77. Webb Interview, *supra* note 56.

78. CSF Survey, *supra* note 5, at 11-13.

79. CSF Survey, *supra* note 5, at 30-33. Both Idaho and Nevada also require restitution prior to reinstatement.

80. *Id.*

81. The ABA is currently considering drafting legislative models to serve as guidelines for the states. Strengthening the creditor position of the CSF would take the cooperation of a number of factions, and would require a change in Bankruptcy Code. Webb Interview, *supra* note 56.

The California legislature recently enacted AB 3089 (Connelly), which subrogates the CSF to the rights of a successful CSF applicant against the attorney whose dishonest conduct caused the pecuniary loss to the Fund, and authorizes the Bar to bring an action against the attorney causing the loss within three years from the date of payment to the applicant. The Governor has signed AB 3089 (Chapter 484, Statutes of 1988).

82. The State Office of the Auditor General recently made the same recom-

mendation. In a June 1988 report, the Auditor General found that the Bar was not routinely informing complainants of the existence of the CSF, and recommended that the Bar "should inform potential claimants of the availability of the Client Security Fund when they file a formal complaint that an attorney has misused trust funds." Office of the Auditor General, *A Review of the State Bar of California's Processing of Complaints Against Attorneys Accused of Misusing Client Trust Funds*, Audit No. P-716 (June 1988) at 23. (For a complete summary of the Auditor General's report, *see infra* agency update on OFFICE OF THE AUDITOR GENERAL.)

83. CSF Survey, *supra* note 5, at 21-24.

84. Letter from Kiyoko Tatsui to State Bar Discipline Monitor Robert C. Fellmeth, *supra* note 23, at 4.

In his Third Progress Report of the State Bar Discipline Monitor (September 1988), Professor Fellmeth makes a similar recommendation: "We believe that CSF claims should be combined with the discipline process, with [the Office of Trial Counsel] carrying the case as part of the underlying discipline. Where there is a settlement or judgment, resolution of the CSF claim and any concomitant duty of the respondent to contribute should be included." *Id.* at 155-56.

For its part, the California CSF Commission has adopted an "early payout policy," under which it will examine claims before final discipline is imposed but after the attorney has become the subject of an interim suspension proceeding under Business and Professions Code section 6007(b) or (c), or the Office of Trial Counsel has filed a formal accusation or a stipulation as to facts and discipline against the attorney. This limited acceleration of claim review, however, has been inhibited by a large backlog of cases currently pending before the CSF.

85. Since 1986, the California CSF has added two staff members: a paralegal and an administrative assistant. *See supra* text at notes 43-49.

