University of Michigan Journal of Law Reform

Volume 10

1977

Attorney Misappropriation of Clients' Funds: A Study in Professional Responsibility

Gregory Dunbar Soule
University of Michigan Law School

Follow this and additional works at: https://repository.law.umich.edu/mjlr

 Part of the Legal Ethics and Professional Responsibility Commons

Recommended Citation

Gregory D. Soule, *Attorney Misappropriation of Clients' Funds: A Study in Professional Responsibility*, 10 U. MICH. J. L. REFORM 415 (1977).
Available at: https://repository.law.umich.edu/mjlr/vol10/iss3/3

This Note is brought to you for free and open access by the University of Michigan Journal of Law Reform at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in University of Michigan Journal of Law Reform by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact mlaw.repository@umich.edu.

ATTORNEY MISAPPROPRIATION OF CLIENTS' FUNDS: A STUDY IN PROFESSIONAL RESPONSIBILITY*

Attorneys hold money belonging to their clients in many contexts: settlement monies from lawsuits, funds collected by the attorney on behalf of his clients, real estate deposits held in escrow, fines to be paid on the clients' behalf, advances for costs, and pre-paid legal fees for specific services yet to be performed by the attorney. Disciplinary Rule (DR) 9-102 of the ABA Code of Professional Responsibility[1] requires that any funds belonging to a client[2] should be maintained in a separate bank account apart from monies belonging to a lawyer or his firm.[3] DR 9-102 also requires that the attorney maintain complete records of all the 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 to them.[4]

---

* The author wishes to acknowledge the information and helpful criticism provided by Robert Anderson, James H. Bradner, Jr. and the ABA Center for Professional Discipline, Edmund N. Carpenter II, Norman A. Faulkner, John H. Neiman, and Eric H. Steele.

[1] The ABA Code of Professional Responsibility consists of Ethical Considerations and Disciplinary Rules organized under nine Canons. The Canons express general concepts from which the more specific Ethical Considerations and Disciplinary Rules are derived. Ethical Considerations are "aspirational in character and represent objectives toward which every member of the profession should strive." The Disciplinary Rules, in contrast, are "mandatory in character . . . [and] state the minimum level of conduct below which no lawyer can fall without being subject to disciplinary action." ABA CODE OF PROFESSIONAL RESPONSIBILITY, Preliminary Statement (1969).

The Code of Professional Responsibility was adopted by the House of Delegates of the ABA on August 12, 1969, and became effective for ABA members on January 1, 1970. Forty-seven states have adopted the Code by court rule. Telephone interview with E. Russell Twist, Director of the Department of Professional Standards, ABA (Mar. 21, 1977).

[2] DR 9-102(A) does not require that advances paid by clients for future costs or expenses be maintained in a separate client trust account. One commentator has suggested that the rule is ambiguous as to whether prepaid legal fees for specified services, as distinguished from retainers paid merely to insure the availability of the attorney's services if needed, must be treated as clients' money prior to performance of the legal services. Carpenter, *The Negligent Attorney Embezzler: Delaware's Solution,* 61 A.B.A.J. 338, 340 (1975).

[3] ABA CODE OF PROFESSIONAL RESPONSIBILITY, DR 9-102(A):

> Preserving Identity of Funds and Property of a Client
>
> (A) All funds of clients paid to a lawyer or law firm, other than advances for costs and expenses, shall be deposited in one or more identifiable bank accounts maintained in the state in which the law office is situated and no funds belonging to the lawyer or law firm shall be deposited therein except as follows:
>
> (1) Funds reasonably sufficient to pay bank charges may be deposited therein.
>
> (2) Funds belonging in part to a client and in part presently or potentially to the lawyer or law firm must be deposited therein, but the portion belonging to the lawyer or law firm may be withdrawn when due unless the right of the lawyer or law firm to receive it is disputed by the client, in which event the disputed portion shall not be withdrawn until the dispute is finally resolved.

[4] ABA CODE OF PROFESSIONAL RESPONSIBILITY, DR 9-102(B).

Breaches of professional duties in handling clients' funds account for a large share of the disciplinary penalties imposed on attorneys[5] and occur in a variety of circumstances. The failure to establish a separate bank account for clients' funds and the resulting commingling of a lawyer's funds with those of his client constitute a sufficient ground for discipline, although such a violation of DR 9-102 is not necessarily an indication of illegal intentions or the antecedent to later defalcations.[6] 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.[7] The consequence is often defalcation, which began as careless and unintentional misappropriation but evolved into embezzlement as the "borrowing" continued and increased in amount.[8] Lawyers occasionally "borrow" from clients' funds to cover their own expenses even where a separate client trust account is maintained.[9] Such illegal borrowing frequently involves the attorney in a "web of financial difficulties" that may culminate

[5] In Wisconsin, for example, almost 40 percent of the attorney discipline cases brought before the supreme court between 1957 and 1974 involved misappropriation or commingling of funds held for clients. Memorandum in support of motion, In the Matter of a Supreme Court Rule Requiring Periodic Reports by Attorneys to the State Bar of Wisconsin as to Compliance with the Clients' Trust Funds Account Rule, at 2 (Sept. 29, 1976). Approximately 32 percent of the disciplinary cases adjudicated by New York courts between 1929 and 1962 involved commingling and conversion of clients' money. J. CARLIN, LAWYERS' ETHICS: A SURVEY OF THE NEW YORK CITY BAR 154 (1966).

[6] 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 attorney's personal expenses or subjected to the claims of his creditors. "The rule against commingling was adopted to provide against the probability in some cases, the possibility in many 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). Furthermore, the failure of the lawyer to separate his personal funds from those of his clients gives the appearance of impropriety and reduces public confidence in the legal system and profession. Accordingly, commingling must be discouraged even in circumstances where it involves little risk of defalcation. ABA CODE OF PROFESSIONAL RESPONSIBILITY, EC 9-5. *See, e.g.*, Committee on Professional Ethics & Conduct v. White, 209 N.W.2d 11 (Iowa 1973); *In re* Windsor, 231 Or. 349, 373 P.2d 612 (1962); *In re* White, 24 N.J. 521, 132 A.2d 777 (1957).

[7] *See, e.g.*, Florida Bar v. Loveland, 249 So. 2d 19 (Fla. 1971); *In re* Banner, 31 N.J. 24, 155 A.2d 81 (1959); Clark v. State Bar, 39 Cal. 2d 161, 246 P.2d 1 (1952).

[8] *See* note 145 and accompanying text *infra*. The chairman of a committee appointed by the Delaware Supreme Court to study and make recommendations regarding the accountability of attorneys for clients' funds concluded:

> A thread that appeared to run through most, if not all, of the problem was the apparent commingling by the attorney of his own funds with those of his clients. Attorneys initially may have felt that they were spending their own funds, though in fact clients' funds were being diverted for personal purposes. At some point mere negligence became blatant embezzlement.

Carpenter, *supra* note 2, at 338.

[9] *See, e.g.*, State v. Ruskin, 126 So. 2d 142 (Fla. 1961), where the misappropriations were precipitated when the attorney overextended himself in speculative business investments at a time when he was suffering severe mental pressures and personal domestic problems. Despite the mitigating circumstances, the attorney's subsequent repentance and rehabilitation, and his restitution of all funds owed, the Court suspended the attorney for six months.

in substantial defalcations involving the funds of many clients.[10] Unfortunately, other cases of defalcation involve attorneys who have deliberately stolen from their clients.[11]

The legal profession's response to the problem of attorney misappropriations traditionally has been limited to establishing and enforcing standards for admission to and expulsion from the bar.[12] Recently, however, the profession has expanded its efforts beyond merely regulating membership in the bar. Since 1959, almost every state[13] has established a clients' security fund, either by the promulgation of court rules[14] or through the actions of state bar associations,[15] in order to compensate aggrieved clients. Subject to maximum dollar limitations for any single award,[16] the funds reimburse defrauded clients presenting eligible claims.[17]

The legal profession has initiated disciplinary processes and clients' security funds in order to achieve certain objectives. This

---

[10] *In re* Baron, 25 N.J. 445, 449, 136 A.2d 873, 875 (1957).

The testimony of a state bar association president noted in the Clark Report suggests that attorney misappropriation is usually part of a course of conduct and is not an isolated incident which is unlikely to be repeated. ABA SPECIAL COMMITTEE ON EVALUATION OF DISCIPLINARY ENFORCEMENT [the CLARK COMMITTEE], PROBLEMS AND RECOMMENDATIONS IN DISCIPLINARY ENFORCEMENT (final draft June 1970) at 18 [hereinafter cited as the CLARK REPORT].

[11] *See, e.g.*, State v. Inglis, 160 So. 2d 701 (Fla. 1964); State v. Hoffman, 157 So. 2d 137 (Fla. 1963).

[12] These efforts have usually focused on the expulsion of dishonest members. *See* notes 19-25 and accompanying text *infra*. Efforts to prevent the admission of dishonest persons to the bar have been minimal.

> The bar also attempts to screen out potentially immoral or unethical practitioners in the process of admission to the bar. However, examination into the moral character of the applicant is uniformly of a limited and routine nature, except for those suspected of political nonconformity. . . . Only a very small fraction of applicants are rejected on character grounds.

J. CARLIN, *supra* note 5, at 162 n.1.

A few courts exercising their jurisdiction over the attorney as an officer of the court have attempted to aid defrauded clients by entertaining summary proceedings against the offending attorney. These courts have directed the attorney to pay money owed to his clients, attached the attorney's property to cover the debt, or punished the attorney by fine or imprisonment. Permitting such summary proceedings is a matter of judicial discretion, and clients have no absolute right to invoke this summary remedy. *In re* Long, 287 N.Y. 449, 40 N.E.2d 247 (1942); Akers v. Akers, 233 Minn. 133, 46 N.W.2d 187 (1951).

[13] Other than North Carolina, which has plans to establish a fund, only Utah and Wisconsin have not established clients' security funds. ABA STANDING COMMMITTEE ON CLIENTS' SECURITY FUND, REPORT TO THE HOUSE OF DELEGATES 1 (Aug. 1976). Funds have also been established in a number of foreign countries, and also in eight Canadian provinces. Bryan, *Clients' Security Fund Ten Years Later*, 55 A.B.A.J. 757, 759 (1969).

[14] Nine of the 29 state funds responding to an ABA-sponsored questionnaire were created by court rule or statute. ABA STANDING COMMMITTEE ON CLIENTS' SECURITY FUND & ABA CENTER FOR PROFESSIONAL DISCIPLINE, PRE-PUBLICATION DRAFT OF THE SURVEY OF CLIENTS' SECURITY FUND, 1972-1974 [hereinafter cited as CSF SURVEY], schedule C, col. 21. After the accuracy of the pre-publication draft has been verified, a final draft of the Survey will be published in the near future.

[15] Twenty of the 29 state funds responding were established by state bar associations. CSF SURVEY, *supra* note 14, at schedule C, col. 21.

[16] *See* notes 87-93 and accompanying text *infra*.

[17] *See* notes 69-86 and accompanying text *infra*.

article will delineate these objectives and evaluate whether they have been satisfied. Moreover, it will propose additional goals that the legal profession, given its present status as a self-regulating profession, should attain in satisfying its responsibility for governing the professional conduct of its members. Finally, additional measures that several states have instituted in order to complement the efforts of disciplinary agencies and clients' security funds by fulfilling unsatisfied needs of professional responsibility will be examined.[18]

I. EXISTING INSTITUTIONS

A. The Functions of Discipline and the Disciplinary Agencies

The legal professional has traditionally limited its post-admission efforts at self-regulation to disciplining attorneys who have violated the Code of Professional Responsibility.[19] Based upon the inherent judicial authority to regulate the conduct of officers of the court, the judiciary generally exercises the power to discipline errant attorneys, although the legislature may also employ this power.[20] In most states, the courts have delegated the authority to process complaints, conduct investigations, and hold evidentiary hearings to bar associations, while retaining ultimate control over the imposition of disciplinary penalties.[21] Although private reprimands and public censures have been used increasingly, the traditional sanctions for attorney misconduct have been suspension for a specific period of time or disbarment with the possibility of subsequent reinstatement.[22] The courts have usually employed disbarment and suspension as sanctions, because the primary goal of professional discipline is to remove unworthy members from the

---

[18] These additional measures include minimum bookkeeping and accounting requirements, filing of an annual certificate by each attorney that outlines efforts to comply with the disciplinary rules regarding client trust accounts, and limited audits or "compliance checks" of the attorney's books and records. *See* notes 118-184 and accompanying text *infra*.

[19] Steele & Nimmer, *Lawyers, Clients, and Professional Regulation*, 1976 AM. B. FOUNDATION RESEARCH J. 917, 926 (1976).

[20] In *In re* Opinion of the Justices, 279 Mass. 607, 180 N.E. 725 (1932), the court held:

> It is an inherent power of [the judicial branch of the government] ultimately to determine the qualifications of those to be admitted to practice in its courts, for assisting in its work, and to protect itself in this respect from the unfit, those lacking in sufficient learning, and those not possessing good moral character.

Id. at 609-10, 180 N.E. at 727. *See generally* CLARK REPORT, *supra* note 10, at 10-18.

[21] Arkin, *Self-Regulation and Approaches to Maintaining Standards of Professional Integrity*, 30 U. MIAMI L. REV. 803, 807-08 (1976).

[22] Steele & Nimmer, *supra* note 19, at 924-25; Comment, *Discipline of Attorneys in Maryland*, 35 MD. L. REV. 236, 248 (1975).

bar.[23] Punishment of the individual attorney has generally been disavowed as an objective of professional discipline.[24] Rather, disbarment and suspension are usually justified on the ground that they are the only effective means of protecting the public from dishonest attorneys and preserving the legal profession's reputation for honesty and trustworthiness.[25]

The risk of future misconduct and injury to clients would increase if the punishment of offending attorneys was such as to allow them to continue practicing law. First, it would be difficult to monitor the performance of an attorney who has once violated the Code of Professional Responsibility in order to guard against repeated misconduct.[26] The intricate and specialized nature of legal work usually prevents clients from intelligently evaluating an attorney's performance.[27] Yet the complexity of legal work, the discretionary latitude that is inherent in the delivery of professional services,[28] and the requirements of confidentiality regarding the affairs of clients probably preclude the effective regulation of attorney conduct by anyone other than the client. In view of these constraints, the most effective method of insuring that an offending attorney will not violate the professional code of conduct again is to remove him from the profession.[29]

---

[23] *E.g.*, In testimony before the Clark Committee, a state supreme court justice stated, "[t]he essential purpose of the grievance committee is to remove from the practice of law attorneys who might harm the public and the courts." CLARK REPORT, *supra* note 10, at 98. *See also* Steele & Nimmer, *supra* note 19, at 925-929.

An attorney charged with champerty or excessive advertising probably does not merit disbarment or suspension. When an attorney misappropriates client funds, however, the misconduct strikes at the heart of the fiduciary relationship between an attorney and his client and should be viewed as one of the gravest forms of misconduct, warranting expulsion. State v. Ruskin, 126 So. 2d 142 (Fla. 1961); Bar Ass'n v. Marshall, 269 Md. 510, 307 A.2d 677 (1973). *See* notes 31-35 and accompanying text *infra*.

[24] Comment, *The Objectives of Attorney Discipline: A Pennsylvania View*, 79 DICK. L. REV. 558, 561 (1975).

The Supreme Court has observed, "The proceeding [removal of an attorney as an officer of the court] is not for the purpose of punishment, but for the pupose of preserving the courts of justice from the official ministration of persons unfit to practice in them." *Ex parte* Wall, 107 U.S. 265, 288 (1882).

[25] *In re* Melnick, 383 Ill. 200, 48 N.E.2d 935 (1943). Some courts view discipline as a means of "vindicating the court's dignity," because an attorney has "brought contempt upon the administration of justice." *See, e.g., In re* Long, 287 N.Y. 449, 454, 40 N.E.2d 247, 249 (1942). Other courts, however, describe their disciplinary functions as being for "the welfare of the public, which is always a silent litigant in matters of this type." State v. Ruskin, 126 So. 2d 142, 143 (Fla. 1961).

[26] Some courts consider a violation to be conclusive evidence of a flaw in the attorney's "character" that disqualifies him from further service as an attorney. *See, e.g.*, People v. Smith, 290 Ill. 241, 251, 124 N.E. 807, 811 (1919).

[27] Leach, *The New Look in Disciplinary Enforcement in England*, 61 A.B.A.J. 212, 214 (1975).

[28] Steele & Nimmer, *supra* note 19, at 1002.

[29] As the Pennsylvania Supreme Court observed, "There is only one discipline for such a man for the protection of other possible clients, and that is to put it out of his power to misuse his position as a member of the bar, by disbarring him from further practice." Moyerman's Case, 312 Pa. 555, 563, 167 A. 579, 583 (1933).

The limited capacity of the bar to oversee attorney conduct also diminishes the deterrent effect of sanctions that are imposed for misconduct. Since discovery of a violation of the professional code of ethics is uncertain or unlikely,[30] severe sanctions must be imposed on the relatively few offending attorneys who are discovered in order to deter other attorneys. Thus, while the imposition of a less severe punishment than disbarment may be fair with respect to the individual offending attorney, it may not serve the broader interests of the public and the profession in deterring misconduct by other attorneys.

Given the importance of effective professional self-regulation in preserving public faith in the integrity of the administration of justice[31] and maintaining the legal profession's reputation for trustworthiness,[32] disbarment is also justified in cases of attorney misconduct that involve willful disregard or betrayal of the client's interests.[33] The Code of Professional Responsibility states that the loss of the respect and the confidence of society and of the members of the legal profession is the "ultimate sanction" for unethical conduct.[34] An attorney who betrays his clients' interests, however, indicates that he has inadequate concern for this "ultimate sanction." Thus, even if a lesser penalty than disbarment might reform the attitudes of an offending attorney and instill in him a proper respect for his professional obligations, his removal from the profession is necessary to facilitate the restoration of public confidence in the bar.[35]

In attorney defalcation cases, however, the profession may impose lesser penalties in order to attain a second goal, which is the protection of the financial interests of the aggrieved clients. The

---

[30] Based on a survey of the New York City bar, one commentator concluded, "[v]ery few violators are caught and punished by the formal disciplinary machinery of the bar. We estimate that only about 2 percent of the lawyers who violate generally accepted ethical norms are processed, and fewer than 0.2 percent are officially sanctioned." J. CARLIN, *supra* note 5, at 170. *See also* Comment, *supra* note 24, at 582.

[31] *See* ABA CODE OF PROFESSIONAL RESPONSIBILITY, EC 9-1.

[32] *See* Moyerman's Case, 312 Pa. 555, 564, 167 A. 579, 583 (1933).

[33] Misappropriation or misuse of a client's funds clearly falls within this class of professional misconduct. *See, e.g.*, State v. Goldman, 127 Neb. 340, 255 N.W. 32 (1934); People v. Simmons, 341 Ill. 340, 173 N.E. 398 (1930); People v. Smith, 290 Ill. 241, 124 N.E. 807 (1919).

[34] ABA CODE OF PROFESSIONAL RESPONSIBILITY, Preamble.

[35] *See, e.g., In re* Gottesfeld, 245 Pa. 314, 317, 91 A. 494 (1914), where the court concluded that when an attorney was convicted of conspiring to conceal assets from a trustee in bankruptcy, disbarment necessarily followed:

> The disbarment that followed was not punitive, but protective simply. Courts can command public confidence only as those who serve therein are themselves observant of the law which it is the duty of the courts to enforce. In his high office, the attorney-at-law is a minister of justice; he ceases so to be when, whether in the line of his professional work or outside of it, he prostitutes his knowledge of the law and the skill he has acquired therein to thwart the law by deceit and falsehood.

Id. at 495.

disbarment of a misappropriating attorney may substantially impair his ability to earn an income so that it will be more difficult for his clients to enforce judgments for conversion.[36] On the other hand, if the disciplinary agency moderates the penalties imposed for defalcation on the condition that the attorney reimburses his clients, the offending attorney is given an incentive to make restitution. Some courts and disciplinary agencies, influenced by these considerations[37] and by the fact that the client has not suffered permanent injury if restitution is made,[38] are willing to impose lesser penalties for defalcation.[39] Yet to the extent that attorney misconduct is treated as a private dispute between the attorney and his clients, the efforts of the legal profession to preserve its integrity and to protect the general public may be substantially undercut.[40]

The conflict between the goals of purging the profession of dishonest attorneys and securing restitution for defrauded clients is reflected in the responses of clients whose funds have been misappropriated. Clients understand the professional standard of conduct concerning attorney defalcations because it corresonds to general criminal standards of theft. Clients may also be able to determine when the standard has been violated, since the resulting loss involves a specific amount of money rather than a relatively uncertain claim of legal rights. Although these considerations suggest that client complaints of misappropriation are more likely than other complaints to be brought to the attention of disciplinary agencies,[41] some attorneys guilty of misappropriating clients' funds are never disciplined.[42]

---

[36] *See* note 106 *infra*.

[37] *See* CLARK REPORT, *supra* note 10, at 99.

[38] *See, e.g., In re* Reed, No. 97 (Del. Sup. Ct. 1977). Citing the fact of the attorney's full restitution, the court limited discipline to a public censure and a $5000 fine, even though the attorney had not previously attempted to make up the shortage in the four years following his initial misappropriation. *See also In re* Saba, 253 N.Y.S.2d 323, 22 App. Div. 2d 14 (1964).

[39] One commentator has suggested that most conversion cases in which restitution is made following a complaint to a disciplinary agency rarely result in disbarment. If disbarment occurs, a reinstatement in several years is often the ultimate disposition. Letter from Michael Franck, Executive Director of the State Bar of Michigan, to the author (Jan. 24, 1977). (This letter and all other letters quoted in the article are on file in the offices of the UNIVERSITY OF MICHIGAN JOURNAL OF LAW REFORM.

[40] By withholding discipline when restitution is made, the ethical standards of the profession are not maintained and the confidence of the public is diminished. The offending attorney may misappropriate the funds of other clients, perhaps without further detection. The minimal risks involved in unsuccessful attempts at conversion fail to provide an effective deterrent to attorney defalcations. CLARK REPORT, *supra* note 10, at 98.

[41] The factors which cause a client to lodge a complaint are crucial, because investigations of an attorney's conduct seldom occur without a client complaint. Other lawyers and judges rarely lodge complaints against their colleagues. Furthermore, disciplinary agencies generally lack the authority or the desire to investigate attorney behavior in the absence of a client complaint. Marks & Cathcart, *Discipline Within the Legal Profession: Is It Self-Regulation?*, 1974 U. ILL. L.F. 193, 206-07 (1974).

[42] Although disciplinary agencies may reduce the penalties imposed on defalcating attorneys, the agencies generally are not responsible for the fact that some attorneys completely

In order to maximize the opportunity for restitution, the aggrieved client or an attorney subsequently retained to represent the client may seek a private settlement with the offending attorney rather than a filing of a disciplinary charge.[43] Even where there is the possibility of an award from a client's security fund, the client may still seek a private settlement. The criteria which claimants must satisfy before becoming eligible for a fund award[44] may substantially delay or completely deny an award to the client. For example, many funds require that an attorney be disciplined by the bar before an award may be made to the victimized client,[45] and this requirement may subject the client to an unacceptably time-consuming series of disciplinary proceedings.[46] If the client is eligible for a clients' security fund award, the maximum dollar limitations on the award of many funds[47] may result in less than full reimbursement of his losses. Consequently, even a claimant eligible for an award may decide to pursue a private settlement.

The decision of clients to seek private settlements rather than to file complaints in cases of attorney defalcation weakens professional discipline by failing to prevent or deter the misappropriating attorney from engaging in further embezzlements.[48] Moreover, the pressure on the attorney to make restitution to a client in order to avoid disciplinary penalties may jeopardize the monies of other clients of the attorney.[49] Private settlements thus clearly undermine the profession's efforts to discipline defalcating attorneys. In the absence of an alternative means by which clients can receive

---

escape sanction. Disciplinary personnel accord a high degree of credibility to client complaints alleging misappropriation. Marks & Cathcart, *supra* note 41, at 206-07. As a result, defalcation complaints are more likely to survive the initial screening by disciplinary agencies which results in the summary rejection of as many as 90 percent of all client complaints. Steele & Nimmer, *supra* note 19, at 982.

[43] CLARK REPORT, *supra* note 10, at 169. Attorneys retained by clients seeking restitution from a defalcating attorney must promptly report the offending attorney's misconduct. "A lawyer possessing unprivileged knowledge of a violation of a Disciplinary Rule shall report such knowledge to a tribunal or other authority empowered to investigate or act upon such violation." ABA CODE OF PROFESSIONAL RESPONSIBILITY, DR 1-103(A).

[44] *See* notes 69-86 and accompanying text *infra*.

[45] *See* notes 80-86 and accompanying text *infra*.

[46] John W. Bryan, a past chairman of the ABA Standing Committee on Clients' Security Fund, has estimated that the usual delay between the filing of the complaint and the conclusion of the disciplinary process is from one to three years. Bryan, *supra* note 13, at 757. As the Clark Report recognized, the delay between the receipt of a complaint and the entry of a court order imposing discipline is a significant problem in disciplinary enforcement. The delay is attributable to the backlog of cases, the haphazard scheduling, and the numerous stages in the disciplinary procedure which "far exceed the requirements of due process." CLARK REPORT, *supra* note 10, at 30-38, *See also* Florida Bar v. Randolph, 238 So. 2d 635 (Fla. 1970), where disbarment proceedings did not reach the court until seven years after the initiation of the disciplinary process and over ten years from the dates of the earliest alleged defalcations.

[47] *See* notes 87-92 and accompanying text *infra*.

[48] CLARK REPORT, *supra* note 10, at 168.

[49] *Id.*

substantial and prompt reimbursement, however, there may be little prospect for avoiding such settlements, unless the defalcations which lead to settlements can be prevented.

B. Clients' Security Funds

The clients' security fund is a means by which the members of the legal profession contribute their own monies to reimburse clients injured by the dishonest actions of their lawyers.[50] Many funds, 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.[51] Alternatively, other funds are financed by fees assessed against each attorney which are specifically designated for the clients' security fund and are in addition to bar dues.[52]

Trustees appointed by the court or the bar association administer the funds' operations[53] and generally serve without compensation.[54] The trustees are authorized to manage and invest the assets

---

[50] Since 1970, New Jersey has authorized the payment of over $1,000,000 in claims. Amster, *Clients' Security Funds: The New Jersey Story*, 62 A.B.A.J. 1610, 1614 (1976). Michigan has reimbursed approximately 75 claimants since 1969, providing over $370,000. Letter from David O. Haughey, Chairman, Client Security Fund Committee of the State Bar of Michigan, to the author (Nov. 15, 1976).

[51] Of the 34 funds responding, 17 funds received lump sum appropriations as needed, and 10 received appropriations regardless of need. CSF SURVEY, *supra* note 14, at schedule C, cols. 19a-19d.

The Oregon fund, for example, is authorized to draw its money from transfers by the board of governors of other state bar funds, annual payments of up to five dollars which the board of governors may impose on each active member of the bar, investment income of the fund, and claims recovered against the attorneys whose clients have been reimbursed by the fund. OR. REV. STAT. § 9.635 (1975).

[52] Of the 34 states responding, 8 funds are financed by the direct assessment of state attorneys or bar association members. CSF SURVEY, *supra* note 14, at schedule C, cols. 19a-19d.

In Delaware, for example, the amount levied against each attorney varies with the length of time the attorney has been a member of the bar. For lawyers who have been in the Delaware Bar for ten or more years, the annual assessment is $100. However, once the fund has accumulated net assets of over $100,000, the subsequent assessment for all members is only $10. DEL. CT. R. 32A(5).

[53] *E.g.*, DEL. CT. R. 32A(1)(b); IOWA CT. R. 121.1(b); MD. CT. R. 1228(b)(2); N.J. CT. R. 1:28-1(a).

For example, the court-established Iowa fund is administered by a seven person commission, which is empowered to recommend rule changes to the court concerning attorney defalcations and to assist the court in administering Iowa's program of compliance checks. Two of the seven commissioners must be nonlawyers. IOWA CT. R. 121.1(c).

[54] *E.g.*, DEL. CT. R. 32A(2)(f); IOWA CT. R. 121.1(f); MD. CT. R. 1228(c)(6); N.J. CT. R. 1:28-1(e). Twenty-six of the thirty-five funds responding do not permit attorneys to receive a fee for representing a client before the trustees. CSF SURVEY, *supra* note 14, at schedule C, col. 16.

of the fund, to evaluate the claims of aggrieved clients, to make awards, to enforce claims for restitution arising by subrogation or assignment,[55] to file written and financial reports, and to hire consultants, legal counsel, and other employees.[56] 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, what is the proper amount of reimbursement.[57]

1. Debt of Honor–Two objectives or justifications are commonly cited as the reason for creating clients' security funds. The first objective is premised on the belief that the profession as a whole owes defrauded clients a "debt of honor."[58] The profession represents its members to the public as being "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."[59] The client has "relied upon the profession's collective representation"[60] and the profession has an obligation to remedy the losses stemming from such reliance.[61]

Most commentators have contended that only full reimbursement of all clients' losses can totally repay the professional debt of honor.[62] Therefore, in judging the success of existing funds in satisfying this objective, the extent to which the funds have

---

[55] *See* note 82 and accompanying text *infra*.

[56] *E.g.*, DEL. CT. R. 32A(3); IOWA CT. R. 121.3(d); N.J. CT. R. 1:28-4,-5; WYO. CT. R. 22(3,4).

[57] *See, e.g.*, DEL. CT. R. 32(A)(7)(a); IOWA CT. R. 121.3(j)(2); WYO. CT. R. 22(3). *But see* Folly Farms I, Inc. v. Trustees of the Clients' Security Fund of the Bar of Md., No. 159 (Md. Ct. App., filed Sept. 16, 1976), where the Maryland Court of Appeals discussed its amendment of the court rules governing the clients' security fund permitting claimants whose claims have been denied by the trustees to appeal their decision to the court. The trustees can be reversed by the court where the trustees' decision was arbitrary and capricious, was unsupported by substantial evidence on the record considered as a whole, was not within the authority vested in the trustees, was made upon unlawful procedure, or was unconstitutional or otherwise illegal. MD. CT. R. 1228(j)(2). *See* notes 90-92 and accompanying text *infra*.

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

[59] Note, *The Disenchanted Client v. The Dishonest Lawyer: Where Does the Legal Profession Stand?*, 42 NOTRE DAME LAW. 382, 385 (1967).

[60] *Id.*

[61] Some courts have justified the judiciary's responsibility for attorney discipline in analogous terms, as an effort to prevent the detrimental reliance of clients on dishonest attorneys which may have been encouraged by collective representations of professional competence:

> By admitting [an attorney to the bar] the court presents him to the public as worthy of its confidence in all his professional duties and relations. If afterwards it comes to the knowledge of the court that he has become unworthy it is its duty to withdraw that endorsement, and thereby cease to hold him out to the public as worthy of professional employment.

In re Davies, 93 Pa. 116, 121 (1880).

[62] *See, e.g.*, Amster, *supra* note 50, at 1613; Atkins & Kane, *Clients' Security Fund Maintains Bar's Integrity*, 44 FLA. B.J. 130, 132 (1970). *But see* notes 93-97 and accompanying text *infra*.

reached the goal of full reimbursement should serve as the primary criterion. Three significant aspects of existing funds have limited their ability to attain the objective of full reimbursement.[63]

One aspect in which many funds are deficient is the failure to publicize their activities. Since clients will present claims against a fund only if they are aware of its existence, publicity about a fund is essential.[64] Accordingly, some funds pursue an aggressive public relations policy, publicizing the names of the clients whose claims are satisfied, the name of the defalcating attorney, and the nature of the misconduct involved.[65] Other funds, perhaps motivated by the idea that publicity about lawer misconduct is a gratuitous and misguided effort at self-exposure,[66] do not extensively publicize their existence and activities.[67]

The criteria that a claimant must satisfy to be eligible for an award constitute a second limitation on the capacity of present funds to provide full reimbursement. Particular justifications may be cited to support each eligibility criterion, but the pertinent inquiry in each case is whether the justifications outweigh the consequences of the fund's inability to indemnify fully the injured clients who cannot satisfy the eligibility criteria.[68]

All clients' security funds limit their reimbursements to losses attributable to intentional attorney misconduct and do not reimburse losses due to attorney negligence.[69] Nevertheless, it may be

---

[63] The inadequacies of clients' security funds have caused several jurisdictions to consider mandatory bonding of all attorneys as an alternative to the funds. *See, e.g.*, Carpenter, *supra* note 2, at 338. Bonding has been almost universally rejected, however, primarily because of its expense. Moreover, bonding would effectively transfer the power to determine which lawyers should practice law from the bar admissions committees and the courts to the surety companies. Manahan, *Lawyers Should be Audited*, 59 A.B.A.J. 396 (1973).

[64] There appears to be a positive correlation between public awareness of the fund and the number of claimants. Letter from John W. Gould, Chairman, Oregon Client Security Fund, to the author (Feb. 7, 1977).

[65] Of the 34 state funds responding, 15 funds indicated that they publicized the activities of their funds. CSF SURVEY, *supra* note 14, at schedule C, col. 17. The publicity policy of the Florida Bar, for example, is expressly aimed at encouraging all clients who have suffered losses to apply for reimbursement. Letter from Norman A. Faulkner, Staff Counsel for the Florida Bar, to the author (Jan. 31, 1977).

[66] Outcault & Peterson, *Lawyer Discipline and Professional Standards in California: A Progress Report*, 24 HASTINGS L.J. 675, 686 (1973); Atkins & Kane, *supra* note 62, at 130.

[67] Of the 34 state funds responding, nineteen funds indicated that they do not engage in any publicity. CSF SURVEY, *supra* note 14, at schedule C, col. 17.

[68] Two eligibility criteria require little discussion. Claims arising from misconduct that occurred before the establishment of the fund are usually denied. *E.g.*, IOWA CT. R. 121.3(j)(1)(b); MD. CT. R.1228(i)(5). A few funds require that claims must be brought within a relatively short period of limitations. Note, *supra* note 59, at 394.

[69] While this limitation corresponds to the practice of funds in other common law countries, the Norwegian fund reimburses losses stemming from both malpractice and dishonesty. It has been argued that effective protection of clients requires either the creation of funds with such expanded coverage or the institution of mandatory malpractice insurance. Bryan, *supra* note 13, at 760; Interview with James H. Bradner, Jr., Assistant Director, ABA Center for Professional Discipline (Jan. 6, 1977). Since 1971, every practicing lawyer in Ontario, Canada, has been required to participate in a compulsory errors and omissions

difficult to distinguish between malpractice and intentional theft in cases where the client has paid an advance fee for particular services,[70] 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 advance fee has been kept by the attorney.[71] Partial performance of the services, however, may preclude reimbursement from the clients' security fund for the losses, thus relegating the client to procedures established by the bar to arbitrate fee disputes.[72]

A few of the clients' security funds established by voluntary, nonintegrated state bar associations independently of legislative or court authorization have limited the scope of reimbursable losses to claims involving attorneys who are members of the association.[73] These organizations justifiably question their obligation to cover losses stemming from actions of nonmember attorneys whose conduct cannot be effectively monitored by the association. However, since one purpose of the funds is to protect the justifiable reliance of clients, such a limitation on awards is not entirely appropriate. A client's reliance on the honesty of his attorney is unlikely to be contingent upon whether the attorney is a member of the state bar association.[74] Funds established by statute or court rule can more equitably distribute the burden of underwriting awards in states with voluntary, nonintegrated bars, because such funds can draw on contributions from all attorneys in the state.[75]

Another significant limitation on awards from the funds is that the loss must have been suffered in transactions that occurred within the "attorney-client" relationship.[76] For instance, the profession does not recognize any obligation to indemnify losses at-

---

insurance program, which insures every attorney against claims for negligence. Manahan, *supra* note 63, at 397.

[70] Such payments of fees are to be distinguished from "retainers," which are paid to an attorney to assure his availability for possible future employment and belong to the attorney immediately upon payment.

[71] Letter from John. H. Neiman, Chairman, Iowa Client Security and Attorney Disciplinary Commission, to other members of the Commission (Feb. 18, 1976).

[72] Steele & Nimmer, *supra* note 19, at 1011-13.

[73] The bar associations of three states have established funds which provide awards only for losses due to the illegal activities of bar association members. CSF SURVEY, *supra* note 14, at schedule C, cols. 7, 21.

[74] The public is unlikely to distinguish between members and nonmembers of the state bar associations. Bryan, *supra* note 13, at 758.

[75] In Iowa, for example, the fund has been established by court rule and the court has required a contribution from each attorney as a condition of maintaining the right to practice law in the state. IOWA CT. R 121.3(i)(1). Any attorney who fails to make timely payment of the required assessment and has been served with a notice of delinquency is summarily suspended. IOWA CT. R. 121.3(i)(7).

[76] *See, e.g.*, Integration Rule of the Florida Bar, Art. XVII; OR. REV. STAT. § 9.625 (1975); N.M. STAT. ANN. 18-1-2 (Rule 14(6)) (1953).

tributable 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. Some funds also deny claims resulting from an attorney's actions in his capacity as an executor, trustee, guardian, or other kind of fiduciary, provided the attorney was not acting in his professional capacity as a lawyer.[77]

In contrast, the New Jersey fund bases its criteria for a compensable claim on a causal relationship; a loss is reimbursable where the trustees of the fund find that it would not have occurred "but for the fact that the dishonest attorney enjoyed an attorney-client relationship with the claimant at the time of or prior to the loss."[78] In applying this standard, the trustees consider the disparity of bargaining power between attorney and client, their respective educational backgrounds and levels of business sophistication, whether unusual trust and confidence was placed in the attorney because of his status as an attorney, and whether the attorney-client relationship gave the dishonest lawyer access to information about the client's financial affairs that would not ordinarily have been available.[79] By focusing on the nature of the client's reliance on the attorney instead of on whether the transaction was part of an attorney-client relationship, the "but for" test more accurately determines which client claims involve a professional debt of honor.

Many clients' security funds require that a client exhaust his legal remedies against an attorney before he is eligible for an award.[80] The legal expenses involved in satisfying this requirement may deter many clients from applying for an award.[81] Other funds do not require that a client first sue to recover his money, but require that a claimant enter a subrogation agreement with the fund, assigning his rights against the defaulting attorney to the

---

[77] Funds in six states do not permit recoveries for claims arising from an attorney's breach of a fiduciary duty. CSF SURVEY, *supra* note 14, at schedule C, col. 9.

[78] Amster, *supra* note 50, at 1613. The Ontario fund has adopted a similar standard with respect to losses arising from a solicitor's dishonesty in a debtor-creditor relationship. Address by Kenneth Jarvis, Q.C., Joint Meeting of the ABA Standing Committee on Clients' Security Fund and the National Organization of Bar Counsel (Aug. 4, 1973).

In relaxing the attorney-client relationship requirement, the "but for" standard approximates the standard used by the courts in imposing disciplinary penalties or providing summary remedies. A significant number of disciplinary sanctions are imposed for conduct arising outside the attorney-client relationship, and courts have provided summary remedies for victims of attorney defalcation even where a conventional attorney-client relationship did not exist. *See* cases cited in Akers v. Akers, 233 Minn. 133, 137, 46 N.W.2d 87, 90 (1951). *Cf.* note 12 *supra* (discussing the summary remedy).

[79] Amster, *supra* note 50, at 1613.

[80] Nineteen of the 38 funds responding require that a client exhaust all legal remedies against his attorney before applying for an award from the fund. CSF SURVEY, *supra* note 14, at schedule C, col. 4.

[81] In contrast, the summary judicial remedy of restitution against defalcating attorneys avoids imposing this extra burden on defrauded clients. Bowling Green Sav. Bank v. Todd, 52 N.Y. 489, 493 (1873). *See generally* notes 12 and 78 *supra*.

trustees.[82] Many funds also condition payment of awards on the discipline or criminal conviction of the embezzling attorney.[83] This requirement encourages clients and other attorneys to file early reports of professional misconduct.[84] It also ensures that either a court or a disciplinary agency will determine whether a client's losses were caused by a lawyer's dishonest misconduct in his capacity as an attorney, thereby saving the trustees from making such a determination. Unfortunately, this requirement also subjects the claimant to a possibly prolonged delay until final court action is completed, which may encourage him to seek a private settlement instead of filing a complaint and applying for an award.[85] This problem may be solved by authorizing the clients' security fund to make an award prior to the conclusion of the disciplinary process where the necessary facts have been determined or are uncontested.[86]

In addition to inadequate publicity and restrictive criteria for eligible claims, the dollar limitations on the awards of clients' security funds also contribute to the failure of many funds to repay in full the collective "debt of honor" of the profession. Many funds have maximum dollar limitations for reimbursements.[87] The limitations of the New Jersey fund are among the most generous of any fund: $15,000 for any individual claimant and a total of $200,000 for claims stemming from the course of misconduct of any single attorney.[88] In contrast, however, some funds limit their awards to $5,000 per claimant.[89] Since the trustees of most funds are invested

---

[82] *See, e.g.*, N.J. CT. R. 1:28-3(e). The New Jersey fund has had limited success in enforcing claims against attorneys:

> The primary reason is that many of these individuals have not only been disbarred but also have spent a term in prison and are not likely candidates for remunerative employment on their release . . . . Efforts are being made to improve the collectibility of these claims, but the trustees are not sanguine in this area.

Amster, *supra* note 50, at 1613.

[83] Twenty-six of the 38 funds responding require that the attorney be formally disciplined before any award can be made to his clients. In 15 of the 29 jurisdictions responding, conviction of a crime is sufficient grounds for permitting an award. CSF SURVEY, *supra* note 14, at schedule C, cols. 8, 12.

[84] CLARK REPORT, *supra* note 10, at 191.

[85] *See* note 46 and accompanying text *supra*.

[86] Address by J. Stanley Mullin, Chairman, ABA Standing Committee on Clients' Security Fund, Virginia Bar Association (July 15, 1972).

N.J. CT. R. 1:28-3(a)(2) provides:

> If none of these events [professional discipline, criminal conviction] has occurred or is likely to occur, an ethics committee certifies a claim to the trustees as an appropriate matter for their consideration. . . . Where an ethics committee does not act and an attorney cannot be located, is deceased or incapacitated, the trustee may consider timely application directly provided that the trustees find that the claim is an appropriate matter for their consideration.

[87] Twenty-two of the 40 funds responding place maximum dollar limitations on their awards. CSF SURVEY, *supra* note 14, at schedule C, cols. 23, 24.

[88] Amster, *supra* note 50, at 1612.

[89] Six of the 40 funds responding have a maximum dollar limitation of $5000 or less per claimant. CSF SURVEY, *supra* note 14, at schedule C, col. 23.

with the power, which they exercise "at their sole discretion," to determine the amount of each reimbursement,[90] the trustees may make awards in excess of the dollar limitations. On the other hand, the trustees' discretionary powers are seemingly sufficient to permit an award which does not fully reimburse a client's losses, even though the losses are within the dollar limitations.[91] The client probably has no recourse in such a case because clients' security fund awards are usually made as a matter of grace and not as a matter of right.[92]

Several explanations have been advanced in support of the discretionary powers and the dollar limitations on awards to eligible claimants. Provisions for trustee discretion have been justified by the unavailability of statistical data concerning attorney defalcations, which prevents the trustees from accurately estimating the volume and magnitude of future claims and requires the trustees to exercise restraint in making awards.[93] It has also been argued that the dollar limitations of clients' security funds are analogous to the maximum awards payable by the Federal Deposit Insurance Corporation to depositors.[94] The limitations on both FDIC and clients' security fund awards may escape criticism because the small client or depositor, for whom a loss in an amount that is within the limitations would be catastrophic, is fully reimbursed.[95] Dollar limitations are also defended as temporary provisions to protect fledgling funds from being "bankrupted" by large claims during their initial years of existence.[96]

All of these justifications for providing less than full indemnification have merit, yet it can be argued that the real reason for dollar limitations and discretionary powers is the bar's reluctance to pay the money necessary to reimburse all eligible claimants. The ABA Standing Committee on Clients' Security Fund has recently re-

---

[90] *E.g.*, DEL. CT. R. 32A(7)(a); IOWA CT. R. 121.3(j)(2); MD. CT. R. 1228(i)(1); N.M. STAT. ANN. 18-1-2 (Rule 14(a)) (1953).

[91] The trustees of many funds are either encouraged or required to consider several factors in determining the amount of an award: the degree of hardship suffered by the client, the negligence of the client, if any, which may have contributed to the loss, and the amounts available to the fund for payment of awards and the number and size of eligible claims that have been or may be presented. It would seem that any one of these factors might serve as a justification for limiting an award to an amount less than the loss suffered.

[92] *E.g.*, DEL. CT. R. 32A(7)(b); IOWA CT. R. 121.3(j)(4); MD. CT. R. 1228(i)(2); N.J. CT. R. 1:28-3(d). *But see* note 57 and accompanying text *supra*.

[93] Mullin, *Clients' Security Funds: Where We Are, What's Ahead*, BAR EXECUTIVE KEY HANDBOOK (Mar. 1972).

[94] Smith, *supra* note 58, at 128. Address by J. Stanley Mullin, Chairman, ABA Standing Committee on Clients' Security Fund, Arkansas Bar Association (June 4, 1971).

[95] Interview with James H. Bradner, Jr., Assistant Director of the ABA Center for Professional Discipline (Jan. 6, 1977).

[96] Address by J. Stanley Mullin, Chairman, ABA Standing Committee on Clients' Security Fund, Arkansas Bar Association (June 4, 1971).

ported that the majority of funds are either inactive or ineffective.[97] The inactivity or ineffectiveness of these funds stems largely from inadequate financing, which has apparently been a principal problem with the funds since their inception. In 1961, the chairman of the ABA Standing Committee noted that the profession had accepted the obligation to repay a debt of honor, and that "the only one real hurdle" which the funds faced was "the matter of dollars and cents."[98] The chairman found an "unwillingness to appropriate money out of the state bar treasury, resistance to an increase in association dues," and apprehension that the clients' security fund would lead to "the bankruptcy of the state Bar."[99]

The reluctance of attorneys to underwrite the limited awards of existing funds suggests that they may not accept the added financial cost of a program of full reimbursement. Since some funds presently require substantial contributions from every attorney in the state, perhaps attorneys should not be required to shoulder this additional burden alone.[100] One alternative source of funding besides the contributions of attorneys is the interest which might be derived from client trust accounts. Few, if any, attorneys presently maintain their trust funds in interest bearing accounts, but instead place the money in noninterest bearing demand accounts.[101] Attorneys themselves may not keep the interest earned on funds held in trust,[102] and the high turnover of the numerous deposits in any one account makes the proration of the interest earned among clients economically infeasible and often physically impossible.[103] Florida is now considering a program, similar to those in operation in Canada, Australia, and South Africa, which would permit banks to pay interest earned on trust fund deposits to finance clients' security fund awards.[104] Of course, while such a program might permit full reimbursement of client losses, it may be questioned whether clients should be asked to help pay the profession's debt of honor.

---

[97] ABA STANDING COMMITTEE ON CLIENTS' SECURITY FUND, REPORT TO THE ABA HOUSE OF DELEGATES (Aug. 1976).

[98] Voorhees, *supra* note 58, at 494-95.

[99] *Id.* at 495. *See also* Atkins & Kane, *supra* note 62, at 130.

[100] Most attorneys in New Jersey are assessed fifty dollars a year to support the state clients' security fund. N.J. CT. R 1:28-2. Delaware and Iowa attorneys who have been in practice for a number of years must pay one hundred dollars annually until the assets of the fund reach a specified amount, after which the assessment drops to ten dollars per year. DEL. CT. R. 32A(5); IOWA CT. R 121.3(i).

[101] Florida Bar News, Dec. 1976, at 6.

[102] ABA STANDING COMMITTEE ON PROFESSIONAL ETHICS, INFORMAL ETHICS OPINIONS 545, 991 (May 5, 1962), (July 3, 1967).

[103] Brief of the Florida Bar in Support of Petition for Amendment of Integration Rule and Code of Professional Responsibility to Provide for Voluntary Attorney Participation in a Supplemental Clients' Security Fund Program at 12 (Mar. 11, 1977).

[104] *Id.*; Florida Bar News, Mar. 10, 1977, at 4.

2. Preserving the Privilege of Self-Regulation–The second goal of clients' security funds is based upon the expectations of clients and the general public that arise not from the representations of the bar, but from the self-regulating nature of the profession.

> The public looks to the profession to keep its own house in order and when a lawyer embezzles his clients' funds the whole bar is blackened in the public eye. The rest of us, as well as the embezzler, are considered at fault because we have failed to police our own ranks and to prevent the defalcation.[105]

This second justification presumes that the public will view the suspension or disbarment of an offending attorney after a defalcation has occurred as an inadequate response by the profession because these sanctions do not refund the client's money, and the losses of the individual client are seldom reimbursed by the defalcating attorney.[106] Accordingly, the bar perceives the clients' security fund as a means of accommodating the public demand for accountability, while quelling public dissatisfaction and preserving the freedom of the legal profession to regulate itself without public intervention.[107]

It is not clear whether clients' security funds have actually helped to minimize public dissatisfaction with the legal profession's self-regulation.[108] One reason may be the imperfect public understanding that the funds are largely a voluntary undertaking of attorneys who have no binding obligation to provide reimbursement. It has been argued that the public appreciates the gratuitous nature of the fund and understands why losses may not be reimbursed in full.[109] Nonetheless, some victimized clients resent the

---

[105] ABA STANDING COMMITTEE ON CLIENTS' SECURITY FUND, Report 3 (Feb. 1959), *quoted in* Note, *supra* note 59, at 384.

[106] A former chairman of the ABA Standing Committee on Clients' Security Fund has noted that "rarely, in the case of an attorney's misappropriation, is complete or partial restitution made, and rarely is a civil judgment collectible." Address by J. Stanley Mullin, Chairman, ABA Standing Committee on Clients' Security Fund, Virginia Bar Association (July 15, 1972).

[107] One commentator has suggested that self-protection is a primary purpose of the funds. "Although we have often called the clients' security fund a debt of honor, I truly believe that the existing threat to our exclusive self-government makes a clients' security fund a necessary supplement to our existing disciplinary procedures." Address by J. Stanley Mullin, Chairman, ABA Standing Committee on Clients' Security Fund, Arkansas Bar Association (June 4, 1971). Another commentator has suggested that the disciplinary efforts of the agencies of the bar are aimed at forestalling public criticism and control of the legal profession. J. CARLIN, *supra* note 5, at 161.

[108] *E.g.*, Brian E. Toland, a past chairman of the Compensation Fund Committee of the English Law Society, has stated that the client security fund "has done more than anything else to enhance the prestige and honour of the profession." Smith, *supra* note 58, at 125. *E.g.*, Edmund N. Carpenter II has reported that the Trustees of the Delaware Client Security Fund "doubt if any goodwill has been created by their client security fund." Address by edmund N. Carpenter II, ABA Clients' Security Workshop (Feb. 12, 1976).

[109] *See, e.g.*, Bryan, *supra* note 13, at 758.

eligibility limitations on awards and perceive the fund "as an insurance company that is delaying in paying claims rather than a voluntary fund supplied by other attorneys to minimize the bad experience which they have received."[110] In light of these conflicting reports, it is unclear whether the funds have enhanced public goodwill toward the bar.

The publicity that is essential to a public understanding of the contributions of the bar in establishing clients' security funds also necessarily reveals the misconduct of attorneys.[111] Public cognizance of the commendable professional efforts at reimbursement will be accompanied by a greater awareness of the extent of attorney defalcations. Accordingly, questions regarding the profession's capacity for self-regulation may be raised. As a result, publicity concerning awards to claimants might prove counterproductive by leading to public demands that attorney discipline be handled by some agency outside the legal profession.

The dilemma which confronts the profession's efforts to publicize clients' security funds evidences the fact that the funds cannot substitute for an effective program of self-regulation.[112] Payments from such funds will neither deter the misconduct of attorneys nor rid the profession of dishonest practitioners. The funds can only complement the actions of the disciplinary agencies, remedying the injuries of clients that could not be prevented by the bar's efforts at self-regulation. It is doubtful that attorneys are willing to pay the high costs of a primarily remedial approach.[113] Moreover, it is unlikely that public confidence can be maintained through an essentially remedial approach to professional regulation.

II. NEW GOALS AND PROCEDURES

Regardless of whether the present funds and disciplinary agencies have been successful in achieving their goals, the response of the legal profession to the problem of attorney defalcations should also be evaluated in terms of additional goals that the bar should pursue in light of its responsibilities for professional self-

---

[110] Address by Edmund N. Carpenter II, ABA Clients' Security Fund Workshop (Feb. 12, 1976).

[111] This predicament was noted by Douglas Sweet, the director of Research and Development for the Michigan State Bar. "The problem is that in a way we would like to publicize the fund but in another way it carries a degree of negativism, almost like asking people if they know any bad attorneys." Ann Arbor News, Oct. 27, 1976, at 7, col. 1.

[112] Atkins & Kane, *supra* note 62, at 132.

[113] *See* notes 97-100 and accompanying text *supra*.

regulation. In addition to reacting to cases of attorney misappropriation through disciplinary proceedings and clients' security fund awards, the profession has a further obligation to the public and to its members to prevent such misconduct.

To satisfy these additional responsibilities, a few states have developed new instrumentalities, including bookkeeping and accounting requirements,[114] questionnaire and certificate requirements that provide evidence of attorney compliance with the Disciplinary Rules,[115] and periodic "compliance checks" that ascertain whether attorneys have complied with the bank account and bookkeeping regulations.[116] These additional procedures are designed to complement, not to supersede, the disciplinary proceedings and the clients' security funds. In part, the new safeguards are intended to enhance the deterrent value of existing disciplinary penalties by increasing the likelihood that misappropriations by an attorney will be discovered. More importantly, however, these new procedures are designed to provide guidance to attorneys regarding the best ways to handle and to account for the funds of their clients.

A. Trust Account Recordkeeping Requirements

Disciplinary Rule 9-102(B)(3) of the ABA Code of Professional Responsibility requires attorneys to maintain "complete records of all funds, securities and other properties of a client coming into the possession of the lawyer."[117] Several states have elaborated upon this terse statement by promulgating detailed descriptions of the kinds of records and bookkeeping procedures that constitute "complete records."[118] In some states, the specified records and

---

[114] *See* notes 117-47 and accompanying text *infra*..

[115] *See* notes 148-56 and accompanying text *infra*.

[116] *See* notes 157-84 and accompanying text *infra*.

[117] ABA CODE OF PROFESSIONAL RESPONSIBILITY, DR 9-102(B)(3).

[118] DEL. CT. R. 33(2) (adopting the DELAWARE LAWYER'S CODE OF PROFESSIONAL RESPONSIBILITY, DR 9-102, INTERPRETIVE GUIDELINES No. 2 (Supp. 1976) [hereinafter cited as DELAWARE GUIDELINES]; INTEGRATION RULE OF THE FLORIDA BAR, Art. XI, bylaws implementing Rule 11.02(4)(c); IOWA CLIENT SECURITY AND ATTORNEY DISCIPLINARY COMMISSION, MANUAL ON AUDIT PROCEDURES; WIS. CT. R. 256.293(2). A proposed court rule ordering bookkeeping procedures is now before the Pennsylvania Supreme Court. Letter from Carl E. Glock, Jr., to the author (Jan. 25, 1977).

This article will also consider the recordkeeping rules established for Ontario and the latest working draft of guidelines prepared by the ABA Standing Committee on Clients' Security Fund and the ABA Center for Professional Discipline entitled SUGGESTED GUIDELINES FOR RULES FOR THE MAINTENANCE AND AUDIT OF FUNDS, SECURITIES AND OTHER PROPERTY HELD FOR CLIENTS AND OTHERS BY LAWYERS (Nov. 3, 1976) [hereinafter cited as COMMITTEE DRAFT].

In addition to providing recordkeeping and accounting requirements, many of these descriptions also elaborate on the requirement of DR 9-102(A) that clients' funds be deposited in "one or more identifiable bank accounts," by specifying that the bank account must be clearly

procedures are only advisory,[119] whereas in other states the prescribed accounts and accounting procedures are mandatory.[120] Some of the latter states also stipulate that attorneys engaged in practice as a partnership or professional corporation are collectively responsible for compliance with the rules to the extent that they maintain their records on a group basis.[121] All state recordkeeping requirements indicate that the attorney must retain the records for a specified length of time.[122] Attorneys acting as escrow agents, executors, guardians, trustees, conservators, or receivers may be subject to additional accounting requirements pursuant to state law or court rules. Preferable recordkeeping requirements attempt to free such attorney-fiduciaries from duplicative, and possibly contradictory, accounting requirements.[123]

---

labeled as a "trust account" and must identify the attorney or partnership. *E.g.*, WIS. CT. R. § 256.293(1); COMMITTEE DRAFT, *supra* note 118, at § I(B).

The Committee Draft also recommends that a separate fiduciary bank account be maintained for funds held by an attorney in his fiduciary capacity as an escrow agent, executor, guardian, trustee, conservator, or receiver. COMMITTEE DRAFT, *supra* note 118, at § I(A)(1)(a). The recordkeeping directions for such funds require only that the bank account be reconciled monthly and that a list of the funds in the account, the person for whom the funds are held, and the purpose for which the funds are being held be maintained. *Id.* at § IV(B)(8).

The Delaware Guidelines and the proposed Pennsylvania rule also provide for a separate fiduciary bank account for money held in escrow for real estate transactions which may be maintained at the option of the attorney. A separate bank account and simpler accounting procedures are appropriate because attorneys in this type of practice might be involved in a relatively large number of transactions which would not involve a continuing series of disbursements and deposits for the same client. Letter from Edmund N. Carpenter II to the author (Jan. 25, 1977).

[119] *E.g.*, DELAWARE GUIDELINES, *supra* note 118. *See also* Carpenter, *supra* note 2, at 340.

[120] *E.g.*, INTEGRATION RULE OF THE FLORIDA BAR, Art. XI, bylaws implementing Rule 11.02(4)(c); WIS. CT. R. 256.293(2).

[121] *E.g.*, COMMITTEE DRAFT, *supra* note 118, at § III(C); PROPOSED PA. CT. R. § 81.101(2). The shared responsibility parallels the joint liability of lawyers engaged in a group practice for the misappropriations of any one of the attorneys in the firm, despite their personal innocence, based upon their status as partners or as co-trustees of the client trust bank account. *See* Blackmon v. Hale, 78 Cal. Rptr. 569 (Cal. App. 1969), *vacated on other grounds*, 1 Cal. 3d 548, 463 P.2d 418 (1970).

[122] The specified period of retention begins with the year to which the records relate, except in the case of fiduciary records, where the retention period begins only after the completion of the fiduciary obligation. DELAWARE GUIDELINES, *supra* note 118, at 60 (five years); IOWA CT. R. 121.4(a)(3) (five years); PROPOSED PA. CT. R. § 81.101 (2)(b) (seven years); ONT. REG. 983/74, § 19(i)(2)(b) (five years). Since these records will be used primarily by courts either to discipline an attorney or to provide the client with a summary remedy for the attorney's conversion, it is not necessary to establish time limits with reference to any statutes of limitation. Letter from Edmund N. Carpenter II to the author (Jan. 25, 1977). A "reasonable period" which conforms to state tax requirements for business records for record preservation may be established. Such a time period should allow discovery of attorney-embezzlers before records are legitimately destroyed, and it would not impose an additional or conflicting obligation upon attorneys. Letter from John H. Nieman to the author (Feb. 10, 1977).

[123] For example, Florida exempts attorneys from the general recordkeeping requirements insofar as an attorney's handling of a client's funds is subject to an accounting rule imposed by law or court rule. INTEGRATION RULE OF THE FLORIDA BAR, Art. XI, bylaws implementing Rule 11.02(4)(c). The Delaware Guidelines were also drafted with consideration for

The Delaware Guidelines contain the most thorough and effective suggestions with respect to the records and computational procedures that attorneys should use in accounting for clients' funds.[124] Three basic records are recommended: a cash receipts journal listing the source of each receipt and the date of the receipt; a disbursements journal listing the date of each disbursement and the payee; and a subsidiary ledger that contains a separate page for each client for whom monies have been received in trust, showing the dates and amounts of each receipt and disbursement and any unexpended balance.[125] Using these records, bank statements, cancelled checks, and duplicate deposit slips,[126] attorneys are urged to perform two accounting procedures on a monthly basis and to retain a copy of their computations. First, a trial balance of the subsidiary ledger which shows the name of the client and the balance of the client's account as of the end of the month should be calculated.[127] Without such a monthly balance it would be difficult to review the accounts in the event of an audit.[128] Secondly, the attorney should reconcile the cash balances indicated by the receipts and disbursements journal totals, the bank statement balance, and the subsidiary ledger balance.[129] For property other than cash, the Delaware Guidelines suggest only that some kind of record be kept and that the property be specifically identified.[130]

Furthermore, certain records and accounting procedures are suggested for monies received by an attorney that belong to him or

---

existing statutory accounting requirements, so as to avoid duplication or conflict. Letter from Edmund N. Carpenter II to the author (Jan. 25, 1977).

[124] DELAWARE GUIDELINES, *supra* note 118. The Delaware Guidelines were the product of a three-month effort by a committee of attorneys appointed by the Delaware Supreme Court, which worked with a committee of certified public accountants in drafting the accounting and bookkeeping suggestions. Carpenter, *supra* note 2, at 338-39. The Iowa Client Security and Attorney Discipline Commission has recommended the Delaware Guidelines to its attorneys. IOWA CLIENT SECURITY AND ATTORNEY DISCIPLINARY COMMISSION, MANUAL ON AUDIT PROCEDURES 2 [hereinafter cited as IOWA AUDIT MANUAL]. The Committee Draft relies on the Delaware Guidelines in its recordkeeping requirements. Interview with James H. Bradner, Jr. (Feb. 23, 1977).

[125] DELAWARE GUIDELINES, *supra* note 118.

[126] Although the cancelled checks and duplicate deposit slips are listed separately in the Guidelines from the receipts and disbursements journals, the chairman of the committee that drafted the Guidelines has indicated that an attorney may maintain a file of cancelled checks and deposit slips in lieu of these two journals. Letter from Edmund N. Carpenter II to the author (Jan. 25, 1977).

[127] DELAWARE GUIDELINES, *supra* note 118. The current balance shown in the subsidiary ledger should agree with the control figure computed by taking the balance at the beginning of the month, adding the total of clients' money received for the month, and deducting the total disbursements for the month.

[128] Letter from Edmund N. Carpenter II to the author (Jan. 25, 1977).

[129] DELAWARE GUIDELINES, *supra* note 118.

[130] Both the Committee Draft and the proposed Pennsylvania rules have additional requirements for securities and noncash property. Such property must be identified and labeled with the name of the client, and the records of such property must be kept in a separate place from where the property is held. PROPOSED PA. CT. R. § 81.102(b); COMMITTEE DRAFT, *supra* note 118, at § II(A).

his firm. Specifically, the Delaware Guidelines suggest that attorneys keep a cash receipts journal, a cash disbursements journal, a fees book or a file of billing invoices, and a copy of the bank statements, cancelled checks, and deposit slips for the attorney's nonclient bank account.[131] The Guidelines also recommend a monthly reconciliation of the checkbook balance, the bank statement balance, and the cash balance derived from the cash receipts and disbursements journal's totals.[132] Such records are essential if an auditor has to separate commingled client funds and personal monies of the attorney.[133] Moreover, the suggestions may assist attorneys who have only rudimentary accounting skills.

One serious problem with the accounting rules of United States jurisdictions is their failure to define precisely which funds should be maintained in a separate client account and accounted for in accordance with the bookkeeping requirements. DR 9-102(A),[134] which provides the definition of clients' trust funds, is ambiguous as to whether fees paid in advance for specific services yet to be performed continue to belong to the client until the attorney performs the services.[135] In addition, the Disciplinary Rule does not require that advances for costs and expenses be placed in a trust account and treated as clients' funds.[136] Yet if an attorney misappropriated such advances instead of applying them toward the client's expenses, such a defalcation would provide an adequate basis for discipline and a clients' security fund award. In effect, DR 9-102 permits the commingling of advances for costs and expenses, but then punishes the defalcations which may result from such commingling. DR 9-102 also fails to specify that the interest earned by the funds in a client trust account belongs to the attorney's clients and not to the attorney.[137] Since the rules do not mention how interest is to be accounted for, attorneys may innocently misappropriate interest that is earned by clients' funds. There is

---

[131] DELAWARE GUIDELINES, *supra* note 118.

[132] *Id.*

[133] Letter from Robert Anderson, Chief Auditor for the Law Society of Upper Canada, to the author (Jan. 25, 1977); letter from Edmund N. Carpenter II to the author (Jan. 25, 1977).

[134] *See* note 3 *supra*.

[135] *See* note 2 *supra*. The Professional Ethics Committee of The Florida Bar, in interpreting DR 9-102(A), has recently decided that such payments will be presumed to be intended by the client as the property of the attorney upon his receipt of the funds, unless there is evidence that the prepayment was intended and was designated as a "fee security" deposit. FLORIDA BAR COMM. ON PROFESSIONAL ETHICS, ADVISORY OPINION No. 76-77, *published in* Florida Bar News, Jan. 20, 1977, at 5, col. 1. In Iowa, however, the Client Security and Attorney Disciplinary Commission has decided that such prepayments should be retained in trust accounts until earned. NEWS BULL. OF THE IOWA ST. B. ASS'N, (Aug.-Sept. 1975).

[136] *See* note 3 *supra*. It is unclear whether DR 9-102(A) precludes the possibility of treating advances for costs and expenses as clients' trust funds or merely fails to require such treatment.

[137] *See* note 3 *supra*.

also a real question as to whether the attorney has a fiduciary obligation to place his clients' funds in an interest bearing account rather than allow them to lie dormant in a noninterest bearing demand account.[138]

The accounting rules for lawyers in the Canadian province of Ontario,[139] though similar to many of the aforementioned aspects of the Delaware Guidelines, are more successful in delineating which funds must be handled as trust funds. The Ontario definition of "client's trust funds" explicitly requires that advances for costs and fees for services not yet rendered must be maintained in a client trust account.[140] There is also no confusion as to interest earned on clients' funds, because Ontario expressly requires attorneys to hold clients' money in an interest bearing account and to pay the interest to the Law Foundation of Ontario, which uses the proceeds to fund legal education and research, legal aid programs, and law libraries.[141]

A second serious problem with United States accounting rules is their failure to specify which monies must be placed in a client trust account, which monies may be placed in such an account, and which funds may not be deposited in a client trust account. The Ontario bookkeeping rules, in contrast, clearly delineate which funds fall into each of these three categories.[142] Some attorneys may view regulations or suggestions regarding the making of deposits and withdrawals as unnecessary restrictions. The clear definition of the scope of an attorney's duties and discretion provided by such rules, however, is for the guidance as well as the supervision of attorneys, and may be more helpful than coercive.

Despite the variations in the recordkeeping guidelines and requirements of different jurisdictions, the policies justifying the procedures are similar. An ABA-sponsored report on professional discipline advocated that attorneys should be required to keep adequate records of clients' funds.[143] The Clark Report cited two reasons for its recommendation: first, that a recordkeeping requirement would assist disciplinary investigations into complaints of misappropriations, and second, that a combination of accounting rules and a program of annual audits would deter attorney mishandling of funds.[144] In addition to effectuating the goals of discipline and deterrence, however, recordkeeping rules are de-

---

[138] Letter from Edmund N. Carpenter II to the author (Jan. 25, 1977).
[139] ONT. REG. 983/74, §§ 17-20 (The Law Society Act) (1974).
[140] *Id.* § 18(3).
[141] Law Society Act, R.S.O. 1970, ch. 238, § 51(f).
[142] ONT. REG. 983/74, § 18(4-8), (The Law Society Act) (1974).
[143] *See* CLARK REPORT, *supra* note 10, at 173.
[144] *Id.*

signed to instruct and to guide honest attorneys. For example, prescribed bookkeeping and accounting procedures may prevent the negligent misappropriation that can occur when, as a result of inadequate recordkeeping, the attorney negligently spends money for personal purposes.[145] Furthermore, the existence of explicit minimum requirements for recordkeeping, even where the discovery of misconduct is unlikely, confronts a disorganized attorney with the fact that he is in violation of the Disciplinary Rules and therefore may be subject to disciplinary action. Cognizance of his noncompliance may induce the attorney to fulfill his responsibilities. Most importantly, guidelines which encompass more than minimum requirements and provide comprehensive suggestions can perform a "channeling function."[146] The attorney who seeks to comply with the requirements of the Code of Professional Responsibility is provided with a specific model and a standard of conduct, rather than vague exhortations about character and honesty.[147]

B. Certificates of Compliance and Questionnaires

In addition to imposing recordkeeping requirements, several states require attorneys to file annual reports regarding their client trust bank accounts. The simplest kind of trust account report merely requires each practicing attorney[148] to file a statement indicating that he has read and has substantially complied with the

---

[145] It has been argued that misappropriating attorneys often did not begin with a fixed intention to embezzle and were initially unaware of any impropriety as a consequence of inadequate accounting or commingling. Carpenter, *supra* note 2, at 338. However, some commentators have insisted that the vast majority of attorney misappropriations are the result of deliberate fraud. Letter from Charles O. Fisher, Chairman, Clients' Security Trust Fund of the Bar of Maryland, to the author (Feb. 3, 1977); Letter from David O. Haughey, Chairman, Client Security Fund Committee of the State Bar of Michigan, to the author (Nov. 15, 1976). The truth probably lies somewhere between these two observations. When attorneys start using client's funds, they may intentionally allow their bookkeeping to become inaccurate and incomplete so as to obscure or excuse their misappropriation. Although bookkeeping requirements are useless as guides for dishonest attorneys, the requirements may serve as the basis for disciplining such attorneys, who might otherwise have avoided a stiff penalty for defalcation by claiming their inadequate records as an excuse. Letter from Norman A. Faulkner, Staff Counsel for the Florida Bar, to the author (Jan. 31, 1977).

[146] *Cf.*, Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799 (1941) (illustrating how legal standards serve as guides and models, in addition to defining the minimum performance required to constitute compliance with mandatory rules).

[147] The chairman of the committee which drafted the Delaware Guidelines noted: "We suggested books and records . . . [so] that those who wanted to be extra safe [could be sure] that by having these specific books and records they were certainly complying with the Guideline." Letter from Edmund N. Carpenter II to the author (Jan. 25, 1977).

[148] Generally, judges or attorneys who are full-time employees of a government agency or a business corporation are not required to file a report because they do not handle the funds of individual clients. *E.g.*, IOWA CT. R. 121.3(i)(4). Similarly, such attorneys are often either exempted from an obligation to contribute to a clients' security fund or are allowed to make a reduced payment. *E.g.*, IOWA CT. R. 121.4(b)(1).

rules regarding client trust accounts.[149] Some states require that every attorney or partnership submit answers to a questionnaire which asks whether adequate records of clients' funds are maintained and whether a separate clients' trust bank account is kept.[150] The questionnaire also requests the attorney to list the banks where clients' accounts are maintained and to disclose the name and number of such accounts.[151] If an attorney fails to submit a certificate or to answer a questionnaire, he may risk summary suspension from the bar.[152]

In addition to requiring attorneys to file a combined certificate and questionnaire, Ontario requires that each attorney employ a public accountant to examine the attorney's records. The accountant does not conduct an in-depth audit, but is only required to ascertain whether the records on their face appear to comply with the Ontario bookkeeping regulations.[153] The report of the accountant does not purport to be an audit. In fact, because the accountant does not verify the accuracy of the records by contacting the attorney's clients, inspect the files of the attorney apart from the records that the attorney furnishes for his investigation, or check on the sufficiency of internal controls, the report offers only slightly more protection than the attorney's own certificate of compliance.[154]

The self-certifying nature of these provisions suggests that questionnaires and certificates of compliance are not designed primarily to expose embezzling attorneys. The principal functions of these requirements seem to be to notify attorneys of their professional responsibilities and to encourage them to satisfy these duties. Thus, the success of a certificate requirement in generating attorney compliance depends upon the expectation that most attorneys will establish a separate bank account for clients' funds and will

---

[149] *E.g.*, DELAWARE GUIDELINES, *supra* note 118; INTEGRATION RULE OF THE FLORIDA BAR, Art. XI, bylaws implementing Rule 11.02(4)(c); N.M. SUP. CT. RULES GOVERNING DISCIPLINE, Rule 11(b); PROPOSED PA. CT. R. § 81.103.

[150] DELAWARE GUIDELINES, *supra* note 118; WIS. CT. R. 256.293(2).

[151] DELAWARE GUIDELINES, *supra* note 118; IOWA CT. R. 121.4(b)(1). While New Mexico does not require a listing of banks and account names and titles, it does require attorneys to describe the actual records maintained for clients' funds in sufficient detail so that the function of each record can be understood. Attorney's Certification of Records Form, as authorized by N.M. SUP. CT. RULES GOVERNING DISCIPLINE, Rule 11(b).

[152] The Iowa rules, for example, provide for the summary suspension of any attorney who fails to submit a questionnaire, provided that a notice of delinquency has been served upon him thirty days prior to his suspension. IOWA CT. R. 121.3(i)(7). Once suspended, the attorney may be reinstated only upon a showing that his prior failure to comply was not willful and that he has subsequently filed the questionnaire answers or certificate. IOWA CT. R. 121.3(i)(9).

[153] Form 3 Report, as authorized by ONT. REG. 983/74, § 20(2) (The Law Society Act) (1974).

[154] Telephone interview with Robert Anderson, Chief Auditor of the Law Society of Upper Canada (Mar. 18, 1977).

keep adequate records in order to be able to sign the certificate in good faith. A questionnaire, on the other hand, does not rely exclusively on the lawyer's conscience. When an attorney knows that his noncompliance with the rules, particularly a failure to maintain a separate client bank account, can be quickly detected,[155] he may be more likely to establish a separate account. Accordingly, if a transfer out of a separate client trust account is required before the attorney can spend the clients' funds, inadvertent misappropriations resulting from lax accounting will be reduced, and intentional defalcations will be easier to identify.[156] By deterring commingling, the certificate and the questionnaire requirements help solve a central problem of attorney defalcations.

C. Audits and Compliance Checks

A number of jurisdictions provide for the inspection of the client trust bank accounts and the accounting records required by DR 9-102.[157] There are basically two kinds of inspections. The first kind consists of comprehensive audits that are triggered by a credible client complaint or by other circumstances constituting good cause. The Florida audit provision, for example, empowers the appropriate disciplinary agency to order a complete audit if the attorney has failed to file a certificate or questionnaire, or if a check that he has drawn on his client trust account has been returned for insufficient funds.[158] Other circumstances which suggest possible misconduct are also sufficient to trigger an audit.[159] For example, if an attorney fails to distribute funds for a client, a broader investigation of his records would probably be justified. The definition of the conditions constituting good cause within the meaning of such rules is broad and general in order to grant disciplinary authorities substantial discretion in their investigations.[160]

In a more comprehensive proposal, the Clark Report recommended that complete annual audits be required of every attorney

---

[155] The questionnaire should include a written authorization to be signed by the attorney that will permit disciplinary officials to inspect the bank accounts claimed by the attorney in his answers to the questionnaire.

[156] Letter from Edmund N. Carpenter II to the author (Jan. 25, 1977).

[157] *See, e.g.*, DELAWARE GUIDELINES, *supra* note 118; INTEGRATION RULE OF THE FLORIDA BAR, Art. XI, Rule 11.02(4)(b); IOWA CT. R. 121.4(a); MD. CT. R. BV18; N.J. CT. R. 1:28-6(a); WIS. CT. R. 256.293(2).

[158] INTEGRATION RULE OF THE FLORIDA BAR, Art. XI, Rule 11.02(4)(a).

[159] Letter from Norman A. Faulkner, Staff Counsel of the Florida Bar, to the author (Jan. 31, 1977).

[160] According to the chairman of the Maryland Clients' Security Fund, the "good cause" requirement was intentionally designed "to allow the disciplinary agencies to discover a possible pattern of defalcation when only the tip of the iceberg is visible." Letter from Charles O. Fisher to the author (Feb. 3, 1977).

regardless of any evidence of wrongdoing.[161] The committees which drafted the Delaware and Pennsylvania guidelines considered requiring such annual audits for each attorney, but decided not to recommend such a requirement.[162] Both committees found that the cost would be excessive, especially for attorneys who, prior to the promulgation of the accounting guidelines, maintained few records. In Delaware, it would also have been difficult to find enough accountants to undertake the work.[163]

The second inspection mechanism is a "compliance check" that involves a cursory examination of the client trust account records in order to determine whether the attorney is maintaining records that satisfy the jurisdiction's bookkeeping requirements. Of the two states with compliance check programs, Iowa has the more successful and highly developed system.[164] The Iowa program employs full-time accountants, rather than relying upon outside public accountants, because full-time staff auditors are more effective in uncovering fraud and are less expensive.[165] Before conducting compliance checks of a few attorneys in a particular county, a

---

[161] CLARK REPORT, *supra* note 10, at 173.

[162] Letter from Carl E. Glock, Jr., Chairman of the Pennsylvania Committee which drafted the proposed court rules, to Michael Franck (July 21, 1976). Carpenter, *supra* note 2, at 339.

[163] *Id.*

[164] The Iowa program was established by court rule in late 1973. In 1974, its audits were confined to 29 attorneys against whom specific complaints had been lodged. In 1975, the auditors, who are employed by a special commission that the court created to administer the client security fund and the audit program, completed regular audits and compliance checks at over 542 law offices. The average estimated cost of each compliance check was between 25 and 50 dollars. Letter from John H. Neiman to the author (Oct. 28, 1976); THE CLIENT SECURITY AND ATTORNEY DISCIPLINARY COMMISSION, 1975 ANNUAL REPORT.

The trustees of the Delaware Client Security Fund have been authorized to undertake a program of compliance checks and audits. As in Iowa, audits are financed by the same monies used to provide awards to clients. The trustees have experienced difficulties in starting their program, because they have been unable to accumulate a sufficient amount in the fund to begin compliance checks. Substantial defalcations, which might have been detected early or deterred altogether if a compliance check program had been in operation, have depleted the assets of the fund on several occasions and postponed the compliance check program. Address by Edmund N. Carpenter II, ABA Clients' Security Workshop (Feb. 12, 1976).

Since 1962, Ontario has had a program of inspections involving "spot audits" which are conducted on a random basis, "blitz audits" which cover all the law offices in a certain geographical area, and comprehensive audits which result from client complaints about an attorney's conduct. The audit staff includes five chartered accountants. While they concentrate on audits based upon complaints or suspicious circumstances, the auditors also conduct over 30 "blitz" audits each month. Address by George H. Lockhead, Chairman, Disciplinary Committee of the Law Society of Upper Canada, Board of Governors of the State Bar of Wisconsin (Apr. 18, 1975); Letter from Robert Anderson to the author (Nov. 29, 1976).

[165] In Ontario, it has been found that as a result of their extensive experience in conducting the cursory "blitz" and "spot" audits, the staff auditors have become specialists in this field. Hence, they require less direction than outside accountants and know where to look for evidence of financial irregularities. Staff auditors are also more adept at preparing audit reports which laymen can understand and are better witnesses at disciplinary hearings. Letter from Robert Anderson to the author (Jan. 25, 1977).

preliminary letter is sent to all attorneys in the county. The letter informs the attorneys of approximately when the checks will occur and reminds them that the checks are not the result of any complaints, but are conducted regularly on a random basis. By notifying the attorneys in the target area of the impending inspections, the letter enables them to update their books. It also facilitates the arrangement of appointments to conduct the audit at the attorney's office.[166] Most importantly, such a letter to all area attorneys, which reminds them that an audit may be triggered without probable cause, removes the stigma that might otherwise attach to an attorney who is subjected to an audit by the disciplinary agency.[167]

The actual compliance check investigation is relatively simple. The auditor first ascertains whether adequate records[168] are being kept. Then he inspects the account records, the check book, the bank statements, the deposit slips, and the cancelled checks to determine if there is any evidence of misappropriation.[169] If the inspection reveals that there is reasonable cause to believe that a defalcation has occurred, the auditor ceases his inspection to allow the State Bureau of Criminal Investigation to conduct a complete criminal inquiry.[170] Lesser forms of misconduct, such as inadequate recordkeeping, are usually reported to the commission which operates the clients' security fund and inspection program, and the commission contacts the attorney about correcting the deficiencies.[171]

Attorneys sometimes refuse to allow an auditor to inspect their records, basing their objections either on a fifth amendment claim of privilege from self-incrimination or on the need to preserve

---

[166] IOWA AUDIT MANUAL, *supra* note 124, at 2.

[167] Once subjected to an audit, an attorney may be informally stigmatized by his peers even though his books and records are found to be in compliance with the requirements. By using both compliance checks which are conducted on a random basis and regular audits which are based on complaints, no suspicions of guilt are likely to arise from the fact that an attorney has been audited. Carpenter, *supra* note 2, at 340.

[168] Although Iowa has recommended the Delaware Guidelines to its attorneys, *see* notes 124-33 and accompanying text *supra*, it has only required the maintenance of records which show the disbursements, the receipts, and the balance for each client. IOWA AUDIT MANUAL, *supra* note 124, at 1, 2.

[169] The Iowa Audit Manual sets out the principal steps for the auditor to follow:

> Usually, the auditor will first examine the lawyer's trust account by reconciling the ledgered client account balances with the trust account check book and bank statement. He should make at least a cursory examination to make certain that trust account checks are not being written to cover personal or business expenses of the lawyer. If the bank statement reflects any overdrafts, an explanation is required. If the clients' accounts reflect debit balances outstanding for any length of time the auditor may ask for an explanation or ask to see the files. . . . In addition, a review should be made of the general office receipts journal to see if clients' funds are being improperly treated.

IOWA AUDIT MANUAL, *supra* note 124, at 1, 2.

[170] *Id.* at 4.

[171] *Id.*

confidential information concerning their clients. Given the present state of the case law, it is unclear whether an attorney can legitimately assert the fifth amendment claim of privilege as the basis for his refusal to release the records of his client trust account that he is required by law or court rule to maintain. One state court has held that the record requirements of DR 9-102, when adopted as a court rule, come within the "required records" doctrine of *Shapiro v. United States*[172] and must be produced for inspection by the proper authorities.[173]

In some states, where the confidential communications relate to an attorney defalcation, a client privilege for the attorney to invoke may not exist.[174] Some states take precautions to prevent the unauthorized disclosure of financial information about clients' transactions[175] and provide safeguards to limit disclosure if the records are used in disciplinary proceedings involving the attorney.[176] Apparently, the confidentiality objections of many attorneys are based less on a concern for their clients' privacy than on their apprehension about a review of their records by a fellow

---

[172] 335 U.S. 1 (1948). The Court held that because the records requested by investigating authorities were required to be kept pursuant to federal regulation and were therefore "public" in nature, a defendant could not withhold the records from an authorized agency request based on his fifth amendment privilege.

[173] Andresen v. Bar Ass'n, 269 Md. 313, 305 A.2d 845 (1973), *cert. denied*, 414 U.S. 1065 (1973). *But see* Spevack v. Klein, 385 U.S. 511 (1967), where the Court held that the imposition of discipline on an attorney, who refused to respond to inquiries into his professional conduct on the ground that to do so might tend to incriminate him, violates the attorney's constitutional rights.

[174] In Wisconsin, for example, there is no client privilege as to a communication relating to an attorney's breach of his duty to his client. WIS. CT. R. § 905.03(4)(c). In Parry-Jones v. Law Soc'y, 1 Ch. App. 1 (1967), the court stated:

> The law implies a term into a contract whereby a professional man is to keep his clients' affairs secret and not to disclose them to anyone without just cause. . . . [But] the contract between solicitor and client must be taken to contain this implication: the solicitor must obey the law, and, in particular, he must comply with the rules made under the authority of statute for the conduct of the profession. If the rules require him to disclose his client's affairs, then he must do so.

[175] The proposed Wisconsin rules, for example, stipulate that the attorney's records will not be disclosed except upon order of the Wisconsin Supreme Court, or for use as evidence in a disciplinary hearing if the attorney has failed to comply with DR 9-102. Disciplinary agency personnel who make unauthorized disclosures of attorney records are subject to punishment. *Wisconsin Clients' Trust Funds Accounts Compliance Rules*, Wisconsin B. Bull. at 56 (Aug. 1976).

[176] Florida, for example, makes the following provision for the protection of clients:

> [N]otice of such intended use shall be given to any client involved, if practicable, unless such client is already aware of such intended use, and upon good cause shown by such client the admission of the same shall be under circumstances as shall be reasonably calculated thereafter to protect the confidence of such client. . . . Permissible means of protection shall not prejudice the respondent or accused attorney, and may include but are not limited to excision, in camera production, retention in sealed envelopes or similar devices.

INTEGRATION RULE OF THE FLORIDA BAR, Art. XI, Rule 11.04(4)(c). *See also* CAL. BUS. & PROF. CODE § 6087, Rule 120.

lawyer, especially if he is a competitor.[177] Where an impartial auditor conducts the investigation and there are safeguards against unauthorized disclosure of the investigative finidings, few attorneys refuse to divulge information based on the attorney-client relationship.[178]

While a compliance check program is more controversial than recordkeeping, certificate, or questionnaire requirements,[179] it fulfills several professional self-regulation objectives. A program of compliance checks that is combined with a useful set of accounting guidelines furnishes disorganized attorneys with the motivation and the means to maintain adequate records, thus decreasing the risk of "negligent" defalcations.[180] In addition, spot checks and recordkeeping rules deter attorneys who may otherwise "borrow" from their clients' funds.[181] Furthermore, with regard to the attorney who is not deterred, compliance checks may uncover defalcations before they involve substantial sums of money and numerous clients.[182] As a result, the lawyer may still be financially able to make restitution. Even if restitition is impossible, however, early detection of the defalcation may minimize the client security fund payments needed to reimburse the losses.

In addition to serving deterrent and enforcement functions, the existing compliance check procedures also perform a guidance role for the profession. Where advance notice is given of impending compliance checks, an inspection can serve as an opportunity for lawyers to become educated in proper trust accounting methods and will alert them to their professional responsibilties in this area.[183] In fact, auditors in Iowa and Ontario devote a substantial

---

[177] Letter from John H. Neiman to the author (Feb. 10, 1977).

[178] *Id.*

[179] A proposal for bookkeeping requirements, a certificate of compliance, and audits or compliance checks of the required records was considered recently by the Pennsylvania Bar Association, but only the bookkeeping and certificate proposals were finally recommended to the Supreme Court for promulgation as court rules. Interview with Carl E. Glock, Jr., Chairman of the Pennsylvania Committee which drafted the proposed rules (Oct. 14, 1976).

[180] Q. JOHNSTONE & D. HOPSON, LAWYERS AND THEIR WORK: AN ANALYSIS OF THE LEGAL PROFESSION IN THE UNITED STATES AND ENGLAND 479 (1967).

[181] *Id.*

[182] Letter from John H. Neiman to the author (Oct. 28, 1976). Defalcation by an attorney often involves the funds of more than one client. For example, the Ontario Clients' Security Fund, from its inception in 1953 until the end of 1976, has made awards to 958 clients on account of only 104 former solicitors. Letter from Robert Anderson to the author (Jan. 25, 1977).

[183] IOWA CLIENT SECURITY AND ATTORNEY DISCIPLINARY COMMISSION, 1974 ANNUAL REPORT 7

The Iowa Audit Procedures Manual closes with the reminder that "the vast majority of lawyers are honest, but some are dilatory, and some do not keep sufficient records. Hence, a part of the job of the auditor is to assist in educating the lawyer." IOWA AUDIT MANUAL, *supra* note 124, at 4.

amount of time to counseling and consulting with attorneys in addition to their primary task of checking the adequacy of attorneys' financial records.[184] In this respect, compliance checks can be conducted as part of a preventive program that has few grievance or disciplinary functions.

III. CONCLUSION

In 1970, the Clark Report observed that the attitudes of attorneys toward professional discipline ranged from apathy to active hostility.[185] Frequently, reform of the self-regulatory mechanisms of the legal profession occurs only when outside forces threaten the professional privilege of self-discipline.[186] The misconceived notion that self-regulation connotes only discipline and punishment is partially responsible for the reluctance of the profession to improve its self-regulatory system. The format of the Code of Professional Responsibility expressly rejects such a limited conception of self-regulation. Admittedly, the Code contains Disciplinary Rules which establish minimum standards for attorneys who seek to comply with the letter, if not the spirit, of the Code. However, the Code also contains the aspirational Ethical Considerations that are intended "for the 'good man,' as a beacon to assist him in navigating an ethical course through the sometimes murky waters of professional conduct."[187] Attorneys deserve the guidance and instruction that recordkeeping guidelines, certificates and questionnaires, and compliance checks provide. Clients' security funds, by compensating for the losses of clients that the disciplinary proce-

[184] Address by Kenneth Jarvis, Q.C., Joint Meeting of the ABA Standing Committee on Clients' Security Fund and the National Organization of Bar Counsel (Aug. 4, 1973); letter from Robert Anderson to the author (Jan. 25, 1977); letter from John H. Neiman to the author (Feb. 10, 1977). Mr. Neiman indicates in his letter that the Iowa auditors, when asked for advice about effective auditing procedures, usually take a "soft pedal" approach, suggesting possible approaches without any dogmatic assertions about a "single, correct" way to keep accounts.

[185] CLARK REPORT, *supra* note 25, at 1.

[186] The Clark Report warned that "[t]he profession does not have much time remaining to reform its own disciplinary structure. . . . Public dissatisfaction is increasing. . . . We will compound our own cure or someone else will mix up a dose that will curl our hair." CLARK REPORT, *supra* note 25, at 8-9. Recently, the ABA Standing Committee on Professional Discipline warned tht if the profession did not deal with the matter of the attorney discipline system in federal courts, Congress may authorize the U.S. attorneys, who are also courtroom adversaries of the private bar, to take over discipline enforcement in the federal courts. Wall St. J., Feb. 14, 1977, at 5, col. 1.

[187] General Motors Corp. v. City of New York, 501 F.2d 639, 649 (2d Cir. 1974).

dures failed to deter, have complemented the traditional efforts at self-regulation. Unlike the new procedures, however, the effects of the funds are strictly remedial and not preventive. Acceptance and implementation of the emerging preventive procedures should demonstrate that effective self-regulation can protect both clients and attorneys without necessarily increasing the use of disciplinary sanctions.

—Gregory Dunbar Soule