

STATE OF MINNESOTA

IN SUPREME COURT

CO-85-2205

ORDER FOR HEARING TO CONSIDER PROPOSED
AMENDMENTS TO THE RULES OF THE
MINNESOTA CLIENT SECURITY BOARD

IT IS HEREBY ORDERED that a hearing be had before this Court in Courtroom 300 of the Minnesota Supreme Court, Minnesota Judicial Center, on May 12, 1995 at 9:00 a.m., to consider the petition of the Minnesota Client Security Board to amend the Rules of the Minnesota Client Security Board. A copy of the petition containing the proposed amendments is annexed to this order.

IT IS FURTHER ORDERED that:

1. All persons, including members of the Bench and Bar, desiring to present written statements concerning the subject matter of this hearing, but who do not wish to make an oral presentation at the hearing, shall file 12 copies of such statement with Frederick Grittner, Clerk of the Appellate Courts, 245 Judicial Center, 25 Constitution Avenue, St. Paul, Minnesota 55155, on or before May 8, 1995 and
2. All persons desiring to make an oral presentation at the hearing shall file 12 copies of the material to be so presented with the aforesaid Clerk together with 12 copies of a request to make an oral presentation. Such statements and requests shall be filed on or before May 8, 1995.

Dated: March 14, 1995

BY THE COURT:

OFFICE OF
APPELLATE COURTS

MAR 14 1995

FILED



A.M. Keith
Chief Justice

OFFICE OF
APPELLATE COURTS

STATE OF MINNESOTA

IN SUPREME COURT

MAY 4 1995

FILED

In Re Petition to Amend the Rules of
the Minnesota Client Security Board

**STATEMENT OF
WILLIAM J. WERNZ**

File No. C0852205

This Statement is submitted in support of the proposal in the above Petition that Rule 3.02 be amended, but I believe that the amendment would be clarified by adding "fraud" to the definition of "dishonest conduct."

I am an attorney at law of the State of Minnesota. From 1987 until 1992, I was the Director of the Minnesota Client Security Board. I practice law with the firm of Dorsey & Whitney P.L.L.P., Minneapolis, Minnesota.

I have represented Mr. Robert Mockenhaupt and Mrs. Helen Ainsley in connection with their civil claims against attorneys John Morgeson and Bruce Wyant, and in conjunction with their Client Security Board claims.

I believe that the amendment to Rule 3.02, Rules of the Minnesota Client Security Board, defining "dishonest conduct," would be improved by making explicit reference to fraud. As explained below, it appears to me best that Rule 3.02(c) be amended to read:

- c. The loss was caused by the dishonest conduct of the lawyer and the claim was not based on negligence; and
 - i. As used in these Rules, "dishonest conduct" means wrongful acts committed by a lawyer in the nature of fraud, theft or embezzlement of money or the

wrongful taking or conversion of money, property or other things of value, including but not limited to:

- (1) Refusal or failure to refund an advance fee when the lawyer performed no work whatever, or an insignificant portion of the services that he or she agreed to perform. All other instances of a lawyer failing to return an unearned fee or the disputed portion of a fee are outside the scope of the Fund.
- (2) Obtaining money or property from a client representing that it was to be used for investment purposes when no such investment was made. The failure of an investment to perform as represented to, or anticipated by, the applicant is outside the scope of the Fund.

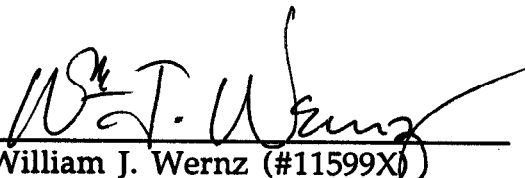
The Board's Petition represents a laudable effort to codify the Board's determinations over the years of the meaning of "dishonest conduct." The Board has historically paid claims involving dishonesty in the form of theft and in the form of fraud. For example, John Flanagan and Mark Sampson, the disbarred attorneys whose misdeeds immediately preceded the creation of the Board, obtained client funds both through theft and through trickery; claims were paid by the Board on both sorts of dishonesty. However, the Rule proposed by the Board omits mention of fraud, except obliquely, in the narrow circumstance of obtaining client funds for investment "when no such investment was made."

"Dishonest" has been defined to mean, "a wilful perversion of truth in order to deceive, cheat or defraud." Webster's Ninth New Collegiate Dictionary, (1986). The proposed Rule 3.02 defines "dishonest conduct" too narrowly. Dishonesty means "fraud" as well as "taking."

For these reasons, the Court is respectfully requested to amend Rule 3.02 of the Rules of the Minnesota Client Security Board, to include "fraud" as part of the meaning of "dishonest conduct."

Dated: May 2, 1995.

DORSEY & WHITNEY P.L.L.P.

By 
William J. Wernz (#11599X)

Pillsbury Center South
220 South Sixth Street
Minneapolis, Minnesota 55402-1498
Telephone: (612) 340-5679

STATE OF MINNESOTA

IN SUPREME COURT

In Re Petition to Amend the Rules of
the Minnesota Client Security Board

**REQUEST OF
WILLIAM J. WERNZ TO
MAKE AN ORAL
PRESENTATION**

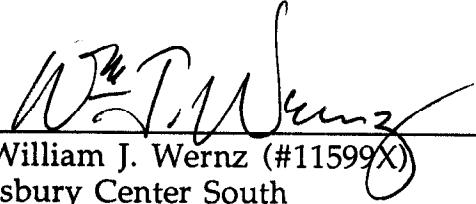
File No. C0852205

I, WILLIAM J. WERNZ, hereby request leave of the Court to make an oral presentation with respect to the proposed amendment to Rule 3.02 of the Rules of the Minnesota Client Security Board, insofar as the proposed amendment does not explicitly include "fraud" in its definition of "dishonest conduct."

Dated: May 2, 1995.

DORSEY & WHITNEY P.L.L.P.

By


William J. Wernz (#11599X)
Pillsbury Center South
220 South Sixth Street
Minneapolis, Minnesota 55402-1498
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FILE NO. CO-85-2205

OFFICE OF
APPELLATE COURTS

STATE OF MINNESOTA

MAY 3 1995

IN SUPREME COURT

FILED

In Re Petition to Amend the Rules
of the Minnesota Client Security
Board.

**REQUEST TO MAKE AN
ORAL PRESENTATION**

TO THE SUPREME COURT OF THE STATE OF MINNESOTA:

Nancy B. Vollertsen, Chair of the Minnesota Client Security Board, files this request to make an oral presentation concerning the petition of the Minnesota Client Security Board to amend the Rules of the Client Security Board. The presentation will be in support of the petition and based upon the written statement previously filed by the Board.

Dated: May 2, 1995.

MINNESOTA CLIENT SECURITY BOARD
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St. Paul, MN 55155-1500
(612) 296-3952

By Nancy B. Vollertsen
Nancy B. Vollertsen
Attorney No. 12266x
P.O. Box 549
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(507) 288-9111

John J. Waters
Attorney at Law
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612-884-5231
Fax 884-5232

May 8, 1995

OFFICE OF
APPELLATE COURTS

MAY 8 - 1995

FILED

HAND DELIVERED

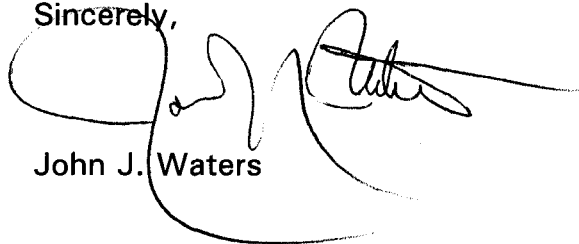
Mr. Frederick Grittner
Clerk of the Appellate Courts
245 Judicial Center
25 Constitution Avenue
St. Paul, MN 55155

Re: Petition of the Minnesota Client Security Board
Case No. CO-85-2205

Dear Mr. Grittner:

Enclosed for filing is the original and twelve copies of my statement in connection with the Petition to amend the Rules of the Minnesota Client Security Board. I am also enclosing the same number of copies of my request for an oral presentation. If there are any questions, please feel free to call me.

Sincerely,



John J. Waters

JJW/jlp

Enclosures

cc: Annette F. and Steven H. Johnson
Philip W. Gleason, Ltd.
Michael Galvin, President,
Minnesota State Bar Association
Marcia A. Johnson, Director,
Offices of the Lawyers' Professional Responsibility Board

OFFICE OF
APPELLATE COURTS

STATE OF MINNESOTA

MAY 8 1995

IN SUPREME COURT

FILED

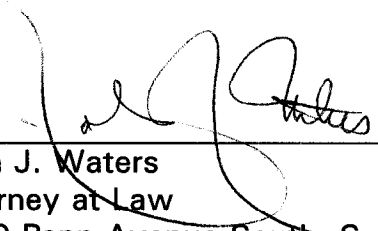
In Re Petition to Amend the Rules of
the Minnesota Client Security Board

REQUEST OF JOHN J. WATERS
TO MAKE AN ORAL PRESENTATION

File No. CO852205

I, John J. Waters, hereby request leave of the Court to make an oral presentation with respect to the proposed amendment to the Rules of the Minnesota Client Security Board and to present my comments as a member of the Minnesota Bar.

Date: May 8, 1995



John J. Waters
Attorney at Law
8120 Penn Avenue South, Suite 158
Bloomington, MN 55431
(612) 884-5231
Minn. Atty. ID# 114777

STATE OF MINNESOTA

OFFICE OF
APPELLATE COURTS IN SUPREME COURT

MAY 8 1995

In Re Petition to Amend the Rules of
the Minnesota Client Security Board

FILED
STATEMENT OF
JOHN J. WATERS

File No. CO852205

John J. Waters as an attorney licensed to practice in the State of Minnesota makes the following statement with regard to the proposed amendments to the Rules of the Minnesota Client Security Board as authorized by the Court's order dated March 14, 1995. In making this statement, I hereby advise the Court that I represent Annette F. Johnson and Steven H. Johnson as well as their corporation with respect to claims presently pending before the Client Security Board (the "Board") which claims are based on intentional dishonesty occurring during the course of an attorney/client relationship. I also represent Philip W. Gleason, Ltd., which also has a claim pending before the Board as a result of a dishonest act of a lawyer during a fiduciary relationship. These claims involved Dennis John Morgeson, Sr., who, by the Court's order dated February 10, 1995 in case number C3-94-1668, was transferred to disability inactive status. These claims also involved Bruce P. Wyant who, by the order of this Court dated October 19, 1994 in case number C3-94-519, has been suspended from the practice of law pending a final determination of the disciplinary proceedings regarding it. Those disciplinary proceedings are currently under consideration by this Court.

The issue presented to the Court is whether or not the proposed changes adequately and properly define the policy of this Court in its capacity as a regulator of attorneys practicing law in the State of Minnesota to aid persons injured by dishonest acts of attorneys.

EXISTING POLICY

Rule 2.01 of the Rules of the Minnesota Client Security Board (the "Rules") sets forth the basic policy of this Court in establishing the Client Security Fund (the "Fund"), to wit:

"there is created a Minnesota Client Security Fund to aid those persons directly injured by the dishonest act of any lawyer during an attorney-client relationship."

While the Rules do not contain an explicit statement behind the policy of establishing the Fund, inherent in the promulgation of this rule and the establishment of this Fund is the determination that the Bar, as part of its public service commitment, should make a voluntary effort to alleviate, insofar as it deems practical, injuries to persons standing in an attorney-client relationship and who sustain pecuniary or property loss as a result of intentional dishonesty of an active member of the Bar.

The Court established criteria to fulfill this policy in Rule 3.02 of the Rules. Those criteria include, among other things, a loss of money or property arising out of and during the course of a attorney-client relationship, and

"c. the loss was caused by the intentional dishonesty of the lawyer and the claim was not based on negligence."

These criteria presently in existence give the Board considerable latitude in considering claims against the Fund, which I agree that it must have. However, as presently stated, the only limitation or exclusion the Rules explicitly contain is noted in Rule

3.01(c) of the Rules which is a claim based on negligence.

More importantly, the Rules do not contain a definition of "intentional dishonesty." Nor do the Rules give insight into how the Board determines which claims are allowed.

PETITION TO AMEND

The Board's petition to this Court details that the Board approved certain amendments to the Rules on November 7, 1994:

"and the Board believes that the proposed amendments would provide greater clarification and notice to members of the public and the Minnesota Bar concerning the requirements for payment by the Board."

The Board has stated that the proposed changes are either administrative, substantive, or reflective of the Board's operating experience. In addition, in its comments to the proposed changes to the Rules, the Board invites scrutiny and comments of the Bar and the public. Therefore, in light of the fact that these proposed changes to the Rules come before this Court at a time when historic cases are pending before the Board, it is urged that the Court consider:

1. the public perception of the Court's exercise of its regulatory authority with respect to the legal profession in aiding persons injured by dishonest acts of attorneys;
2. the public perception as to whether or not the proposed amendments clarify the requirements for payment;
3. the public perception of the appropriateness of this change during the pendency of historic claims; and

4. the public's perception of any attempt to effect or restrict the payment of claims based on present financial limitations of the Fund.

PROPOSED AMENDMENT TO RULE 3.02

In the statement in support of the petition of the Board ("Board Statement"), it states at its comment to Rule 3.02(i):

"The purpose of this section is to provide notice to claimants and attorneys about certain types of conduct covered or not covered by the Rules and thus help potential claimants identify whether they have a claim."

For my clients and myself, this is the first insight that we have had as to what may or may not be covered by the Fund. It is for this reason that we are paying particularly close attention to the Court's policy in this matter.

The present standard for considering claims is found in Rule 3.02 (c): "The loss was caused by the **intentional dishonesty** of the lawyer..." (emphasis added). As proposed, the standard in Rule 3.02 (c) is changed to "The loss was caused by the **dishonest conduct** of the lawyer..." (emphasis added).

The Board Statement further states, that:

"proposals involve either some substantive change or are being proposed to reflect the Board's actual operating experience."

Although standing by itself, the change in the wording of 3.02 (c) from "intentional dishonesty" to "dishonest conduct" appears to expand the rights of an injured person, the change in Rule 3.02 (c) of the Rules is identified by the Board as a substantive change. The change to "dishonest conduct" is believed to severely restrict the rights of the injured person. This is true particularly in the light of the

definition of "dishonest conduct" set forth in subsection (i):

"i. As used in these Rules, "dishonest conduct" means wrongful acts committed by a lawyer in the nature of theft or embezzlement of money or the wrongful taking or conversion of money, property or other things of value, including but not limited to:

- (1) Refusal or failure to refund an advance fee when the lawyer performed no work whatever, or an insignificant portion of the services that he or she agreed to perform. All other instances of a lawyer failing to return an unearned fee or the disputed portion of the fee are outside the scope of the Fund.
- (2) Obtaining money or property from a client representing that it was intended to be used for investment purposes when no such investment was made. The failure of an investment to perform as represented to, or anticipated by, the applicant is outside the scope of the Fund."

Neither the proposed definition by the Board nor its comments provide me (as well as the other members of the Bar and the public) with any insight as to whether or not the Board will consider the impact of fraud on any claim.

The Board's definition of dishonest conduct omits fraud which one reasonably would believe would be included in both a definition of "intentional dishonesty" and "dishonest conduct" and appears to decline to take into consideration those cases where the lawyer's fraud proximately leads to the loss of money or property. In addition, the omission of fraud in the definition of dishonest conduct precludes the Board from commenting on the interplay of whether fraudulent conduct can be so egregious as to override those types of claims specifically excluded in Rule 3.02 (i). In trying to reconcile this omission in advising my clients, I examined the underlying

bases the Board declared that it considered in making the amendments.

The Board Statement acknowledges that the definition of "dishonest conduct" is taken from the California Client Security Fund Rules ("California Rules") and specifically Rule 6. In addition, the Board Statement acknowledges that the ABA Model Rules use a dishonest conduct standard rather than an intentional dishonesty standard. A comparison of the amendments to Rule 6 of the California Rules demonstrates that the Board adopts, for the most part, the essence of sub-paragraphs (a), (b) and (d) of Rule 6 of the California Rules which reads as follows:

"RULE 6. - DEFINITION OF DISHONEST CONDUCT

As used in these rules, 'dishonest act' or 'dishonest conduct' means any of the following:

(a) Wrongful acts committed by a lawyer in the nature of theft or embezzlement of money or in the wrongful taking or conversion of money or property.

(b) Refusal to refund an advance fee when the lawyer performed no work whatever, or such an insignificant portion of the services that he or she agreed to perform, such that the lawyer can be regarded at the time payment was received as having lacked the intention of performing the work. All other instances of a lawyer failing to return an unearned fee or the disputed portion of a fee are outside the scope of the Fund.

(d) Obtaining money or property from a client representing that it was to be used for investment purposes when no such investment was made. The failure of an investment to perform as represented to, or anticipated by, the applicant is outside the scope of the Fund."

However, in basing its amendments on the language in Rule 6 of the California Rules, the proposal leaves out sub-paragraphs (c) and (e):

" (c) The borrowing of money from a client without the intention, reasonable ability, or reasonably anticipated

ability to repay it.

(e) A lawyer's act of intentional dishonesty or deceit which proximately leads to the loss of money or property, by a person with whom the lawyer held an attorney-client or fiduciary relationship."

In pointing out that the ABA Model Rules employ a dishonest conduct standard, the Board invites scrutiny of the Model Rules. The Model Rules define dishonest conduct as:

"C. As used in these Rules, "dishonest conduct" means wrongful acts committed by a lawyer in the nature of theft or embezzlement of money or in the wrongful taking or conversion of money, property or other things of value, including but not limited to:

- (1) Refusal to refund unearned fees received in advance as required by Rule 1.16 of the Model Rules of Professional Conduct; and
- (2) The borrowing of money from a client without the intention to repay it, or with disregard of the lawyer's inability or reasonably anticipated inability to repay it."

ABA Model Rules for Lawyers' Funds for Client Protection, Rule 10 (C) (1989).

Although the Model Rule does not specifically include fraud in its definition, the comments to Rule 10 make clear its intention to include fraud:

"Subsections (1) and (2) make clear that if the essential nature of the transaction was conversion, dishonest conduct will be found even where the lawyer took the money in the guise of a fee, a loan or an investment. Indeed, employing such a ruse is part of the dishonesty. *** Subsection (2) anticipates overreaching by a lawyer, in the context of a loan to the lawyer by a client, to such an egregious extent as to be tantamount to theft. (Citations omitted). Similarly, use by the lawyer of a purported 'investment' to induce a client to turn over money should not preclude a finding of dishonest conduct where the

'investment' is worthless, non-existent and so forth."

These facts, as well as the proposed definition, leave unanswered whether or not the court's policy is correctly reflected in the proposed amendments and raise a number of questions, such as:

1. As to the proposed Rule 3.02(i)(1), does this criteria preclude recovery in an instance where a fee is demanded of and paid by a client in a substantial amount where no significant services are rendered and neither billings nor accountings are provided, that is, are all fees other than "advance fees" excluded?

2. As to the proposed Rule 3.02(i)(2), does this criteria preclude recovery of a loss where the investment is made by a client at the attorney's direction, becomes worthless and was obtained by the intentional fraud and deceit of the attorney?

3. As to California Rule 6(c), does the absence of this provision preclude recovery for a loss of money loaned to an attorney by a client as reflected in this provision?

4. As to California Rule 6(e), does the absence of this provision preclude recovery for a loss based on an attorney's intentional dishonesty or deceit as reflected in this provision? The proposed definition makes no provision for fraudulent conduct. In view of the fact that this is a substantive change, the Court must determine whether or not the change is consistent with its policy of aiding a person injured by dishonest acts of attorneys.

5. Does the definition fairly meet the exclusions contained in professional liability insurance policies maintained by the Minnesota Bar? My policy with

Minnesota Lawyers' Mutual contains the following exclusion:

"any claim for damages arising out of the dishonest, criminal, malicious or deliberately fraudulent act, error or omission of the insured."

CONCLUSION

The California Rules in its preamble under Rule 1 states in part:

"... the practice of law is not a commercial enterprise but an essential public profession devoted to serving the public under rules and regulations designed to provide honest representation in all matters. The spirit of public service is one which does and should motivate the profession of the law. ..."

It is urged that the Court carefully review the proposed amendment of the Rules to be sure that the Client Security Fund is available to aid persons injured by dishonest acts of attorneys.

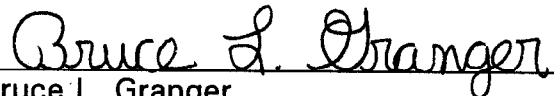
Respectfully submitted,



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May 8, 1995

This statement has been prepared with the assistance of:



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