

FILE NO. C0-85-2205

OFFICE OF
APPELLATE COURTS

STATE OF MINNESOTA

APR 13 2001

IN SUPREME COURT

FILED

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

**PETITION OF THE MINNESOTA
CLIENT SECURITY BOARD**

TO THE SUPREME COURT OF THE STATE OF MINNESOTA:

WHEREAS, the Rules of the Minnesota Client Security Board (RMCSB) were adopted by the Minnesota Supreme Court effective July 1, 1987, and

WHEREAS, Rule 1.06(l), RMCSB, provides that the Board is authorized to make recommendations to the Court on rule changes, and

WHEREAS, the Board has studied a possible amendment to Rule 3.14(c), RMCSB, as fully set out below, which the Board approved on March 19, 2001, and

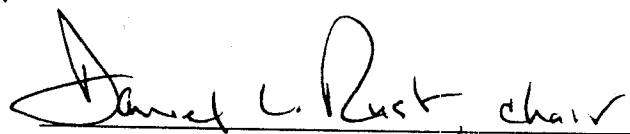
WHEREAS, adoption of this amendment would further fulfill the Board's obligation under Rule 2.01, RMCSB, to "aid those persons directly injured by the dishonest conduct of any lawyer during an attorney-client or fiduciary relationship," and therefore is in the public interest,

NOW, THEREFORE, the Minnesota Client Security Board respectfully recommends that the Minnesota Supreme Court amend Rule 3.14(c), RMCSB, to read as set out below:

c. The maximum amount that may be paid to any claimant for a single claim is ~~\$100,000~~ \$150,000. In exceptional circumstances, the Board may allow a greater or lesser amount based upon the factors set forth in subdivision (b) of this rule.

The Board further recommends that the change to Rule 3.14(c), RMCSB, be applicable prospectively and to all unresolved claims filed with the Board as of the date of the Court's order adopting the change.

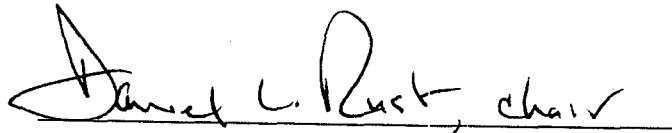
April 12, 2001.



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The Board further recommends that the Court hold public hearings concerning this proposed amendment. A statement in support of the proposed rule amendment is being filed by the Board with this petition.

Dated: April 13, 2001.



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STATEMENT IN SUPPORT OF
PETITION OF THE MINNESOTA
CLIENT SECURITY BOARD

BACKGROUND

The Minnesota Client Security Board was created by this Court in April 1986. The Board's rules were adopted effective July 1, 1987. The Rules twice have been amended, in December 1993 and again in July 1995.

Prior to the 1993 amendments, the Rules provided no maximum amount that could be paid on a claim. Such a maximum amount is commonly referred to as a "cap" on the claim. Prior to 1993, the Board had operated under a policy that the cap was \$50,000 per claim. This policy had been adopted by the Board during its first year of operation and announced in the Board's first annual report.

The 1993 amendments were proposed by the Minnesota State Bar Association (MSBA) in a petition based upon a January 1993 report of the MSBA's Client Protection Committee. Amendments, including a new Rule 3.14(c), were proposed and adopted. By means of the new Rule 3.14(c), a cap was officially established at \$100,000 per claim. This has remained the maximum amount payable per claim to date.

THE PROCESS OF STUDYING THE ISSUE

As was set out in the Board's July 2000 annual report, the Board first considered the issue of raising its cap to some higher amount approximately one year ago. The Board, in its annual report, indicated it intended to study the issue further and, if appropriate, make a recommendation to the Court. The Board revisited the issue at two meetings during the current fiscal year. Information was obtained concerning the

maximum award amounts in other jurisdictions, the Board's history concerning all claims to which the cap had been applied, and the effects on the fund that would have occurred had the cap been at several different higher levels. Finally, in conjunction with the preparation of the Board's annual budget in March 2001, the Board analyzed the current fund balance and the impact that an increase in the cap would likely have upon it and upon future projections, if historical trends were to continue as before. In particular, the Board studied whether an increase in the cap could be handled without any increase in the attorney registration fee.

Minnesota already has one of the highest maximum payment levels in the United States. It appears that only six jurisdictions have maximum payment amounts of more than \$100,000 per claim. The Board did not believe that that fact should end its review, however. The goal of any client protection fund should be 100% reimbursement of all valid claims submitted, if possible. For a limited number of claimants whose losses exceed \$100,000, this obviously is not being accomplished. Plus, the size of the largest claims has grown over the years, such that the uncompensated portion of such claims above the cap has increased.

The statistical information showed that in the eight years since the cap had been formalized at \$100,000 in 1993, eight claims had exceeded the cap and thus received less than full recovery. Obviously, this averages to one such claim per year. Based upon the actual amount of the losses involved, had the cap instead been at \$150,000 throughout those eight years, the Board would have paid an additional \$302,000 on those eight claims, or an average of \$37,737 more per year. Even assuming that the full additional amount had been paid on all such claims, the increase would have been \$50,000 per year, or a total of \$400,000.

1. Effect on the Fund Balance

The fund currently has a balance of approximately \$2.4 million. The Court has established target parameters for the fund of \$1.5 million and \$2.5 million, between

which the fund may remain without adjustment.¹ Had the additional payouts set out above in fact occurred, the current fund balance would still be over \$2 million. The Board is requesting that application of the proposed rule change should be prospective in nature, but also include any pending claims already filed with the Board as of the date of the Court's order adopting this change. Two claims are pending at this time in which the claimant seeks payment of more than \$100,000. In each claim, the total sought is less than \$150,000. If the historical rate of large valid claims continues at an average of one per year, then prospective application of the increase will have minimal impact on the fund balance.

In an effort to determine what could occur should that historical average not prove accurate, however, the Board also considered whether some as yet unknown catastrophic claims situation would destroy the fund's ability to absorb the cap increase. The largest claims total paid by the Board in one year has been \$705,524, in FY96. Had the cap been at \$150,000 at that time, the amount would have been \$805,524. Using that figure, the Board determined what the effect would be in the unlikely event that the Board faced such a catastrophic payout in both of the next two years: the fund balance would fall but only to \$1.55 million, still above the bottom parameter set by the Court. See Attachment 1. Thus, it appears that an increase in the maximum payment per claim to \$150,000 can be safely handled by the fund.²

¹ By Supreme Court order dated May 22, 1998, the Client Security Board portion of the attorney registration fee was set at \$17 per licensed attorney per year. In that same order, the Court established "parameters" within which the fund balance could remain without there being any adjustment to the registration fee. Those parameters were set at \$1.5 million to \$2.5 million. They are to remain in effect until at least May 2003. If the fund balance goes below or above those amounts, the Board is required to report to the Court.

² The Board also considered recommending that the Court raise the cap to \$200,000 per claim, rather than only to \$150,000. The Board was not sure that an increase to that level could be accomplished at this time without a small increase in the attorney registration fee, however. Especially when analyzing the possibility of consecutive catastrophic years, a \$200,000 cap could drop the fund balance below the \$1.5 million mark. Thus, the more modest proposal to raise the cap to \$150,000 was approved.

2. Effect on the Attorney Registration Fee

The amount of the claims paid during the current fiscal year likely will be one of the lowest in the Board's history. The amount of recovery by the Board on its subrogation rights against lawyers on whose behalf claims have been paid has been increasing regularly in recent years. The increased level of the fund balance as a result of these facts generates an increased amount of interest income in favor of the fund. These collective gains will help offset the minimal impact that an additional \$50,000 per year will have on the fund. Therefore, the Board has determined that an increase in the cap can be safely accomplished without any change in the Board's income received through the attorney registration fee. The \$17 per attorney per year that the Board currently receives should remain fully adequate to handle this increase.

Three years ago, the Board voluntarily petitioned the Court to reduce the amount of the attorney registration fee that the Board receives³ because the Board had determined that \$17 per lawyer per year was sufficient to maintain a healthy fund within the Court's established parameters of \$1.5 to \$2.5 million. This has proven correct. Now, with the fund balance in the high end of these parameters, the Board believes that it is appropriate to take advantage of the fund's good health to benefit the victims of lawyer dishonesty, rather than seek to minimally reduce the registration fee again.

CONCLUSION

Ultimately, the issue is what is right. A voluntary cap of \$50,000 existed for six years, the \$100,000 cap rule has existed for eight years. The size of the largest claims faced by the Board has increased over the years. The fund is healthy. It is time to consider another increase. The fund can handle an increase in annual claim payouts

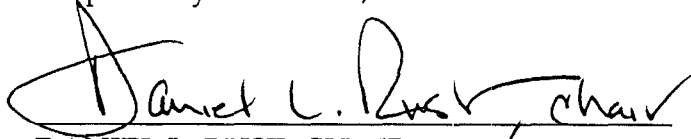
³ Prior to August 1997, the Client Security Board received \$20 per lawyer per year. By order dated August 6, 1997, the Court reallocated \$7 of that amount to the Board of Continuing Legal Education. That temporary reallocation was to terminate on June 30, 1998. The Client Security Board would then again have received \$20 per lawyer. The Board instead petitioned the Court to reduce the amount the fund would receive.

and do so without any increase in the attorney registration fee structure. The Board feels strongly that the recommendation to increase the maximum payment per claim to \$150,000 is the right step to take to better compensate victims of lawyer dishonesty and to remind the public that the Court, the Board and the Bar as a whole are doing all that can be done to protect the public from dishonest lawyers.

The Board recommends that the Court seek public comment and hold public hearings concerning this proposed amendment to the Rules of the Minnesota Client Security Board. The scrutiny and comment of the bar and the public will ensure that the Court has a complete record and basis upon which to adopt the recommended change.

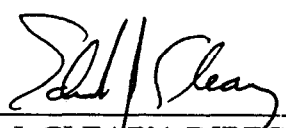
Dated: April 13, 2001.

Respectfully submitted,



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Client Security Board Budget Projections:
(with no increase in attorney registration fee)

	FY01*	FY02	FY03
	(in millions)		
1. No change in \$100,000 cap	\$2.304	\$2.482	\$2.611
2. Cap increased to \$150,000 (\$37,737 more in claims per year)	\$2.304	\$2.443	\$2.518
3. Cap increased to \$150,000 (\$50,000 more in claims per year)	\$2.304	\$2.430	\$2.491
4. Cap increased to \$150,000 (\$805,524 more in claims per year)	\$2.304	\$1.980	\$1.556

* - The Client Security Board fiscal year runs from July 1 to June 30. The Board is currently, until June 30, 2001, in FY01.