

OFFICE OF
APPELLATE COURTS

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ANNUAL REPORT OF
MINNESOTA CLIENT SECURITY BOARD

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June 1989

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I. OVERVIEW.

Rule 1.10, Minnesota Rules of the Client Security Board, provides:

At least once a year and at such other times as the Supreme Court may order, the Board shall file with the Court a written report reviewing in detail the administration of the fund, its operation, its assets and liabilities.

This second annual report of the Minnesota Client Security Board covers the period from July 1, 1988, through May 31, 1989.

The Board has acted promptly to resolve the nearly 100 reimbursement claims the Board has received. As of May 23, 1989, only 11 claims are pending before the Board, with only two claims (which arise out of the same matter) being more than five months old. When the Board began operations on July 1, 1987, it inherited 54 unresolved claims from the former Minnesota State Bar Association Client Security Fund. Forty-four additional claims have been made to the Fund during the first two years.

The Board has paid 51 claims, totalling approximately \$720,000. Thirty-eight claims have been denied as not meeting the requirements for payment under the Board's rules. Almost all of these claims were either malpractice claims or fee disputes, which the Board rules exclude from payment. Two claims were denied because the claimants received full restitution from the attorney or from other sources.

The Board has acted promptly to resolve the specific client security crisis which triggered the Board's creation. Two major Minnesota lawyer defalcations, involving John Flanagan in 1985 and Mark Sampson in 1986, produced many of the claims made to the

Board. Excluding reconsideration requests, all claims concerning Flanagan have been resolved and only one claim involving Sampson (which was not filed until early 1989) remains pending. The Board has paid \$413,137.77 to Sampson claimants. Most of those suffering losses from Flanagan received compensation from banks and insurers.

The Board generally limits payment on any one claim to \$50,000. By adopting a maximum payment amount as a Board policy, rather than recommending a formal rule to the Court, the Board may award more than \$50,000 in cases of extreme hardship, depending on the Fund's resources. Similar limits exist in other states. To date, this maximum amount has only been applied to two claims which would have exceeded the maximum \$50,000 payment. All other claims which met the Board's rules have been paid the full amount.

The Board is in the process of developing and applying guidelines on certain difficult types of claims, such as clients' investments through their attorneys. Another developing policy concerns unearned retainer claims against attorneys who are subsequently disbarred or suspended. These practices are described in more detail below.

The Client Security Board was established in 1986 by the Minnesota Supreme Court. The Board has been funded to date by a one-time Supreme Court assessment of \$100 per attorney. The original assessment raised approximately \$1.4 million. The Board expects to have a fund balance of approximately \$850,000 at the end of its fiscal year, on June 30, 1989.

The Board has five lawyer members and two non-lawyer members, all volunteers, and is chaired by Minneapolis attorney Melvin Orenstein. The Office of Lawyers Professional Responsibility continues to provide staff services to the Board for investigating claims and conducting Board meetings.

The Board also has an educational mission. A brochure explaining Board procedures has been prepared and is now provided to claimants along with claim forms. The Board also has provided speakers to explain the Client Security Board's operation and procedures to law firms or at CLE seminars.

In the coming year the Board will consider several substantial claims which have been deferred until civil litigation was completed. The Board also hopes to continue assisting the Bar Association and the Court in considering whether there are loss prevention measures that can be undertaken economically and effectively.

Board Members. The following individuals serve on the Board:

<u>Name</u>	<u>Term Expires</u>
Melvin I. Orenstein, Minneapolis	June 30, 1990
Gilbert W. Harries, Duluth	June 30, 1991
Jean L. King, St. Paul	June 30, 1989
Constance S. Otis, St. Paul	June 30, 1990
Ronald B. Sieloff, St. Paul	June 30, 1991
James B. Vessey, Minneapolis	June 30, 1990
Nancy B. Vollertsen, Rochester	June 30, 1989

Mr. Orenstein was elected chairman by the Client Security Board. Ms. King and Ms. Otis are public members. All other members are

licensed attorneys. Ms. King and Ms. Vollertsen are eligible for reappointment to another three-year term.

Rules of the Minnesota Client Security Board. The rules took effect on July 1, 1987. The Board's fiscal year runs from July 1 through June 30. The Board met on seven occasions from July 1988, through the end of May 1989.

Funding and Budget. A one-time assessment of all licensed Minnesota attorneys was authorized by the Court in April 1987. The first year, this assessment applied to all licensed attorneys. Now, the Board receives each year only \$50 payments from new attorneys and from those "graduating" from the "less-than-three-year" category. By June 30, 1989, this year's assessment will have generated approximately \$75,000 for the fund. The fund also received approximately \$78,000 in interest income. Budgets are prepared annually, and filed publicly, for approval by the Minnesota Supreme Court.

The assessment is collected through the Office of Attorney Registration and placed into a segregated fund within the state treasury. The Department of Finance issues all payments upon authorization from the Board Chair. The Board does not handle any funds directly or the investment of the Fund.

Administration. The Office of the Director of Lawyers Professional Responsibility provides staff services to the Client Security Board. William Wernz, Director of the Office of Lawyers Professional Responsibility, is also Director of the Client Security Board. Attorney Martin Cole and legal assistant Patricia Jorgensen handle the Client Security Board's investigations on approximately a quarter-time basis. Other

members of the Director's staff also provide assistance to the Client Security Board in its daily administration. The Office of the Director bills the Client Security Board for these services on an hourly basis.

Payment of claims is the Board's largest expense item, with approximately \$235,000 in claims approved this year. The Board projects an additional \$250,000 for claims to be paid for FY'90. Administrative expenses of approximately \$16,000 were incurred by the Board this year. The fund anticipates having a balance of approximately \$850,000 at the end of June 1989, and \$690,000 after June 1990.

II. SUMMARY OF ACTIVITIES AND PROCEDURES OF THE CLIENT SECURITY BOARD.

Major accomplishments for the second year of operation of the Client Security Board have been:

- (1) Resolving claims promptly, so that only eleven claims are currently pending before the Board, and only two are more than five months old. The Board has tried especially to resolve claims soon after disciplinary proceedings and any related civil proceedings are completed.
- (2) Developing policies, practices and guidelines for deciding certain difficult types of claims involving investments and unearned retainers efficiently and fairly.

- (3) Granting personal reconsideration meetings to claimants whose claims are either denied or reduced, in order to insure claimants a full opportunity to be heard before their claim is finally resolved.
- (4) Undertaking informational and educational activities by preparing a brochure explaining the Board procedures, speaking publicly on client security and by assisting the Bar Association and the Court in coordinated efforts to explore means of loss prevention.

A major accomplishment of the Board has been to develop guidelines for investment and unearned retainer claims. These types of claims have proven the most difficult for Client Security Funds nationwide. The Board's guidelines will be available to claimants who make such claims to help them fully understand the standards to be applied to their claims. The practices and guidelines that have been developed to date include:

- (1) Investments. Generally, claims involving an individual investing funds with an attorney are not payable under the Board's rules, since investments are not part of the normal attorney-client relationship or a fiduciary relationship closely related to an attorney-client situation.

The Board will consider investment-related claims where the funds invested were the result of an attorney-client relationship with the respondent attorney, where there is no significant break in time in the attorney-client relationship prior to the investment

with the attorney, and where the "investment" is, in fact, not verifiable.

All payments by the respondent attorney to the claimant or to third parties on the claimant's behalf, whether designated by the respondent attorney as "interest" or a return of principal, will be treated as a return of principal on the original amount entrusted to the attorney.

- (2) Unearned Retainers. Most claims involving a request for return of unearned legal fees or retainers are not payable under the Board's rules, because they are fee disputes which are better resolved through civil litigation or fee arbitration.

Claims for return of unearned retainers may be constitute intentional dishonesty if the respondent attorney receives money from a client with no intention of performing the legal services requested or under circumstances where the attorney knew or should have known that he or she would not be able to perform the services.

This situation will normally occur only when an attorney, under investigation and facing likely disciplinary sanction of suspension or disbarment, accepts advance payment for legal services and it is reasonable to infer that the attorney cannot complete the work in a short period of time; and the attorney does not perform any services for the client and fails

to refund any unearned fees following suspension or disbarment.

The Board granted personal reconsideration meetings to six claimants whose claims were either reduced or denied in the past year and on three occasions either reversed a prior denial or increased the amount of payment to the claimant. The Board believes that all claimants are provided a full opportunity to be heard and to present all documents and evidence in their favor before their claim is finally resolved.

The Board completed preparation of a brochure which is made available to all claimants who request claim forms from the Board. The Board made speakers available to law firms or for CLE presentations to explain the Board's procedures and operation in an effort to meet its educational obligations. William Wernz, Director, is a member of an MSBA-sponsored committee which is currently studying the feasibility of recommending to the Court a trust account overdraft notification rule. Martin Cole, Assistant Director, was on the faculty for the ABA's National Forum on Client Security, in Chicago.

Nineteen new claims were received by the Board during the past year. Thirteen of those claims have already been resolved and six remain pending. In addition, two claims which were carried over from the previous year have yet to be resolved. Those claims, which arise out of the same matter, are awaiting continued efforts of the claimants to collect on a civil judgment against the attorney. The Board paid nineteen claims in the past year, totally approximately \$215,000, including two claims which had initially been denied. Additional payments,

over the amount originally approved, were made on two claims, totalling \$20,000. Ten claims were denied in the past year. The eleven claims pending before the Board, against eight attorneys, total approximately \$1,274,924.10.¹

Claims are initiated by submitting the claim on forms approved by the Board to the Director's Office. The respondent attorney is given an opportunity to respond to the claim in writing. A member of the Director's staff meets personally with the claimant(s) in many cases, unless the claim clearly can be decided solely on the information in the claim or from any documents submitted by the claimant(s).

Claimants are normally required to exhaust readily available civil remedies, including obtaining default judgments against the attorney. In most cases, attorney disciplinary proceedings will have been completed before Client Security payment is made.

If a claim is denied, claimants are notified in writing of the Board's determination and provided an explanation of the basis for the Board's result. The claimant has the right to request reconsideration and a meeting with the full Board, so that the claimant will have full opportunity to present his or her claim before any denial is final.

The Board obtains subrogation rights on all paid claims. The Minnesota Attorney General's office handles all civil claims for the Client Security Board, including subrogation claims.

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Claim received on April 19, 1989, in the amount of \$596,196.76 is to be considered at the June 8, 1989, Board meeting. The claim is recommended to be denied.

Several matters have been referred to the Attorney General's office in the past year for subrogation litigation. Litigation has been or is being conducted in two matters. Recovery of amounts paid out by the Board, however, is never expected to be a significant source of revenue.

III. GOALS AND OBJECTIVES.

1. Claim Resolution.

The Board will continue to monitor matters where disciplinary or civil litigation is pending, so that resolution of these claims will occur promptly upon the completion of the related case. In FY'90, the Board intends to continue to pay all valid claims in full up to the \$50,000 limitation. The Board has budgeted approximately \$250,000 for claim payment next year.

2. Budget.

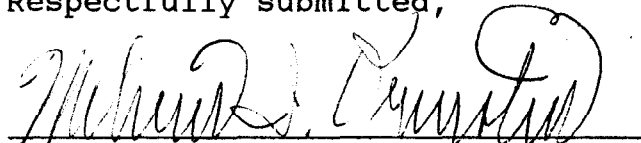
The Board's experience remains consistent with its initial projections for the first three years of operation. Based upon the income generated by the one-time \$100 assessment on all registered lawyers practicing in the state, if no new situations of the magnitude of the Flanagan or Sampson claims occurred, the Board anticipated that the original assessment would decline over three years to approximately \$500,000. The Board has submitted proposed budgets to the Minnesota Supreme Court for fiscal years 1990 and 1991 which are consistent with those projections. If projections concerning valid claims proves accurate, the balance in the Fund will decrease to only \$625,000 by the end of fiscal year 1990.

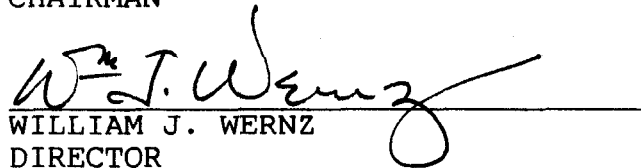
3. Education and Publicity.


The Office of Lawyers Professional Responsibility will continue to notify prospective claimants of the existence of the Fund during disciplinary investigations and help to provide claim forms to potential claimants. Groups are encouraged to contact the Board about speaking opportunities.

The Board's creation was controversial. Its first two years of operation have been successful. The Board continues to receive favorable responses from most members of the bar and the public.

Respectfully submitted,


MELVIN I. ORENSTEIN
CHAIRMAN


WILLIAM J. WERNZ
DIRECTOR


MARTIN A. COLE
ASSISTANT DIRECTOR