

OFFICE OF
APPELLATE COURTS

JUN 20 1988

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ANNUAL REPORT OF

MINNESOTA CLIENT SECURITY BOARD

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June 1988

MINNESOTA CLIENT SECURITY BOARD

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June 15, 1988

The Honorable Douglas K. Amdahl
Chief Justice
Supreme Court of Minnesota
State Capitol
St. Paul, MN 55155

OFFICE OF
APPELLATE COURTS

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Re: Client Security Board Annual Report

Dear Justice Amdahl:

Enclosed for filing are eight copies of the Client Security Board Annual Report which was approved by the Board at its June 6, 1988, Board meeting.

If you have any questions or comments, please contact me.

Very truly yours

William J. Wernz
Director

By Martin A. Cole
Martin A. Cole
Assistant Director

MAC:JD:jd
Enclosures
cc: Office of Appellate Courts ✓

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I. INTRODUCTION.

Rule 1.10, Rules of 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 initial report of the Minnesota Client Security Board covers the period from July 1, 1987 through May 31, 1988.

Overview.

The Minnesota Client Security Board has completed its first year of operation. The Board has acted promptly to resolve the problems it was created to address.

It can be reported with confidence that the crisis in client security that developed in the last few years has been met by good lawyer government. As elsewhere in the professional responsibility system, a combination of volunteers and professionals, the bench and bar, lawyers and members of the public, have worked cooperatively and openly to deal with a new problem. While the newly created Client Security Board system imposes an additional financial burden on the practicing lawyers of the state, there has been little objection, and the lawyer reaction has generally been positive as it has become more and more apparent that the newly created Client Security Board system is an essential means of protecting the public and of preserving the public's confidence in the legal profession.

To date, the Board has paid 28 claims totalling \$448,573. The average (mean) amount paid per claim has been \$17,423.

Twenty-six claims were denied as not meeting the requirements for payment under the Board's Rules. One claim (two claimants) was paid \$40,000 on a hardship basis, although the claim remains open, pending completion of civil litigation. The Board may consider making an additional payment to the claimants on that particular claim. Presently 24 claims are pending before the Board totalling \$663,874.50, against 11 lawyers.

In July 1985, attorney John Flanagan absconded with over \$400,000 in client funds. A little over a year later, attorney Mark Sampson also absconded with over \$450,000 in client funds. Twelve claims totaling \$451,629.19 were filed against the fund, arising out of the Flanagan defalcations. Twenty-nine claims totaling \$477,734.44 were filed against the fund arising out of the Sampson defalcations.

Many victims of Flanagan were able to recover from other sources. As a result, only 12 claims were made against the fund arising out of his misconduct. The Board paid one claim for \$6,300, denied six others, which did not qualify as dishonest acts under the Rules of the Client Security Board, and five claims are pending awaiting the outcome of related civil litigation.

Of the 29 claims filed against Sampson, 14 of those claims have been paid in full for a total amount of over \$315,000. The Board determined that seven of the claims filed against Sampson did not meet the Board criteria for payment, and eight claims are pending. Three of the latter claims were first filed in April or May of 1988, and the remainder have been either awaiting investigative materials to be supplied by the claimant or the disposition of third party litigation.

When the Board began its formal operations on July 1, 1987, it inherited 54 unresolved claims which had been made against the Bar Association Fund, totaling over \$4 million (a claim for \$3 million had been filed which was determined to be a claim of malpractice). Twenty-four additional claims have since been received. The Board has met on a monthly basis, to consider the claims pursuant to procedural rules adopted by the Court. Forty-two old claims and twelve new claims have been resolved. By July 1, 1988, the Board will have paid out approximately \$500,000 to claimants. No payment larger than \$50,000 has been made to any single claimant.

The Minnesota Client Security Board was established on April 15, 1986, upon Petition of the Minnesota State Bar Association, which had sponsored a Client Security Fund for over 20 years funded by the Association through membership dues. The Minnesota State Bar Association determined that it could no longer provide an adequate Client Security Fund, in view of the increased claims against the Fund, and the voluntary nature of its membership, which included only a portion of the practicing lawyers in this state. On July 18, 1986, the Supreme Court appointed a seven member Client Security Board made up of five lawyers and two lay persons.

On April 7, 1987, the Supreme Court of the State of Minnesota, after a Notice and Hearing, approved Rules recommended by the new Client Security Board. The Court also approved the recommendation of the Board for a \$100 assessment on all registered lawyers in the state to become effective on July 1, 1987.

The Board expects to have a fund balance as of July 1, 1988, of approximately \$1 million. The \$100 attorney assessment generated \$1.4 million, and the fund also received \$42,000 in interest income, and \$145,728 from the Bar Association Fund.

The Office of the Director of Lawyers Professional Responsibility has provided staff services to the Board, for investigating the claims made. Administrative expenses, including the Director's Office's services, have totaled approximately \$43,000.

In the coming year the Board hopes to resolve a number of claims which have been deferred until civil litigation is completed. The Board also hopes to consider whether there are any loss prevention measures that can be undertaken economically and effectively. The Board intends to make the public more aware of the service it provides on behalf of the legal profession.

Board Members. The Court appointed the following individuals to the Board:

<u>Name</u>	<u>Term Expires</u>
Melvin I. Orenstein, Minneapolis	June 30, 1990
Gilbert W. Harries, Duluth	June 30, 1988
Jean L. King, St. Paul	June 30, 1989
Constance S. Otis, St. Paul	June 30, 1990
Ronald B. Sieloff, St. Paul	June 30, 1988
James B. Vessey, Minneapolis	June 30, 1990
Nancy L. Vollertsen, Rochester	June 30, 1989

At the initial meeting of the Board, Mr. Orenstein was elected chairman of the Client Security Board. Ms. King and Ms. Otis are public members of the Board. All other members are licensed attorneys.

Rules of the Minnesota Client Security Board. Those rules took effect on July 1, 1987. The Board's fiscal year will run from July 1 through June 30 of each year. The Board met on nine occasions from July through the end of May, or approximately once a month.

Funding. An assessment of all licensed Minnesota attorneys was authorized by the Court. The Board's budget for FY'88 projects that by June 30, 1988, this assessment will have generated \$1.38 million for the fund. The fund also received approximately \$42,000 in interest income and received \$145,728 which was the balance remaining in the former Client Security Fund operated by the Minnesota State Bar Association.

Funds are 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. The Board does not handle any funds directly.

Administration and Budget. The Office of the Director of Lawyers Professional Responsibility is providing staff services to the Client Security Board. William Wernz, Director of Lawyers Professional Responsibility, was also named Director of the Client Security Board by the Court. Attorney Martin Cole and legal assistant Tracy Hoppe are primarily assigned to handle the Client Security Board's investigations on an approximately quarter-time basis. Other members of the Director of Lawyers Professional Responsibility's staff have also provided assistance to the Client Security Board in its daily administration. The Office of the Director of Lawyers Professional Responsibility is billing the Client Security Board for these services on an hourly

basis. Payment of claims is the Board's largest expense item, and \$448,573 in claims have been approved. The total amount expected to be approved in FY'88 is \$529,000, plus administrative expenses of \$43,000. As a result, the fund anticipates having a balance of approximately \$1,002,000 at the end of FY'88.

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

The primary goals and accomplishments for the first year of operation of the Client Security Board have been:

- (1) To adopt procedures for investigating and deciding claims efficiently and fairly, including providing claimants with opportunity to be heard and have claims reconsidered, if appropriate. This includes screening of claims which do not meet the fund's criteria for payment;
- (2) To resolve a backlog of pending claims made to the former State Bar Association fund, some of which were almost two years old;
- (3) To pay valid claims as fully as possible while still maintaining the fund for payment of other valid claims.

Each of these goals has been substantially met in the past year.

When the Board commenced activities on July 1, 1987, 54 claims made to the MSBA Fund were pending against 21 lawyers, totalling \$4.24 million (\$3 million of which involved one malpractice-related claim). Forty-two of those pending claims were resolved during the past year, while twelve of those original claims remain pending without resolution, primarily in

situations where civil litigation against the lawyer or against third parties has not yet been resolved.

Twenty-four claims have been received by the Board after July 1, 1987. Twelve of those claims were resolved and twelve have yet to be heard by the Board. To date, the Board has paid 28 claims, totalling \$448,573. The average (mean) amount paid per claim has been \$17,423. Twenty-six claims were denied as not meeting the requirements for payment under the Board's rules. One claim (two claimants) was paid \$40,000 on a hardship basis, although the claim remains open pending completion of civil litigation. The Board may consider making an additional payment to the claimants on that particular claim. Presently, 24 claims are pending before the Board, totalling \$663,874.50, against eleven lawyers.

The Board has adopted an internal policy of limiting the amount of payment on any one claim to \$50,000. The Board has reserved the right to exceed that amount in very limited cases of extreme hardship. To date, all claims have been paid to the full extent they meet the Board's requirements, although five claims exceeding \$50,000 are pending.

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 with the claimant(s) in most 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. The Board determined that failure to secure a default judgment against Mark Sampson would not preclude payment, however, as it has become obvious that such judgments are presently uncollectible. Claimants are also advised that criminal charges may be sought for intentional misappropriation or conversion. In most cases, attorney disciplinary proceedings will have been completed before Client Security payment is made. Two claims were paid against an attorney who is deceased, where no disciplinary action was involved.

The Board obtains subrogation rights on all paid claims. The Minnesota Attorney General's office will handle all civil claims for the Client Security Board, including subrogation claims. Seven matters against two attorneys have been referred to the Attorney General's office so far for possible subrogation litigation. Recovery of amounts paid out by the Board, however, is not expected to be a significant source of revenue.

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 hearing before the Board, so that the claimant will have full opportunity to present his or her claim before any denial is final.

III. FY'89 GOALS AND OBJECTIVES.

1. Claim Resolution.

The Board will monitor matters where civil litigation is pending, so that resolution of these claims will occur promptly upon the completion of the civil case. The Board expects to be able to reduce the number of meetings to every other month or

quarterly, depending on the number of new claims received this year. In FY'89, the Board intends to continue to pay all valid claims in full up to the \$50,000 limitation.

2. Budget.

The first year's experience of the Client Security Board Fund has been consistent with the initial projections made by the Board for the first three years of the Board's operations. Based upon the income generated by the one-time \$100 assessment on all registered lawyers practicing in the state, and upon the assumption that no claims of the magnitude of the Flanagan or Sampson claims would reoccur, it was anticipated that the fund would decline over a period of three years to approximately \$500,000. The Board has submitted proposed budgets for the fiscal year 1989 and for the fiscal year 1990 to the Minnesota Supreme Court, which are consistent with its initial projections. If the projections concerning the number of valid claims proves accurate, the balance in the Fund will decrease to approximately \$500,000 by the end of fiscal 1990, or sooner should unexpectedly large claims of misappropriation occur.

3. Administration.

The Board plans to begin preparation of a control manual of forms and procedure memoranda for use by the staff. Many standardized forms are already being utilized for regular reports and correspondence. Continued use of standardized forms and procedures will ensure that the Board's investigations remain fair while keeping expenses of administration to a minimum.

4. Education and Publicity.

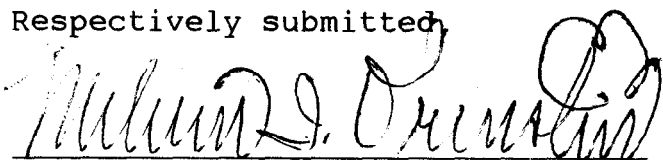
During its first year of operation, the Board gave emphasis to establishing procedures and to resolution of the backlog of

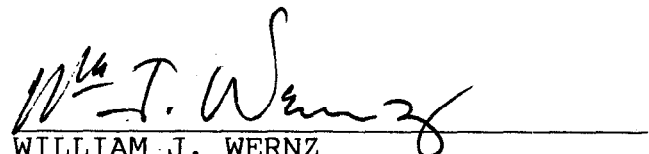
claims. Rule 4.01, Minnesota Rules of the Client Security Board, requires the Board also to engage in educational activities in an effort to help minimize future attorney misconduct. The Board hopes to fulfill this obligation within the next year through preparation of a brochure explaining the Board procedures, which will be provided to all claimants along with claim forms. Arrangements also have been made with the Office of the Director of Lawyers Professional Responsibility to notify prospective claimants of the existence of the Fund during disciplinary investigations and to provide claim forms to potential claimants.

The Board is presently exploring the possibility of recommending to the Court adoption of a trust account overdraft notification rule. The Board hopes to participate in the discussion concerning such a rule, as well as participate in other educational activities including continuing legal education programs.

Overall, the Board has received favorable responses from most members of the bar and the public. The Board hopes to continue to assist victims of intentional dishonesty by attorneys and to help enhance the professionalism of the bar.

Respectively submitted,


MELVIN I. ORENSTEIN
CHAIRMAN


WILLIAM J. WERNZ
DIRECTOR


MARTIN A. COLE
ASSISTANT DIRECTOR