

# The State Bar of California

## Client Security Fund – 2013 Activities Report

### Public Protection

The Client Security Fund, established by Bar-sponsored legislation in 1972, represents one of the State Bar's major efforts to achieve its public protection goals. In addition to disciplinary procedures, as part of the Bar's public service, the Fund helps to alleviate injury to legal consumers who sustain money or property loss as the result of dishonest conduct by a member of the Bar. The Fund is designed to reimburse victims who have lost money or property due to theft, or an act equivalent to theft, committed by a lawyer acting in a professional capacity.

The Fund provides the legal profession with a unique opportunity to promote public confidence in the administration of justice and the integrity of the legal profession. It is also a cost-effective way of providing reimbursement to victims that is generally not available from any other source. The Client Security Fund works closely and cooperatively with the State Bar's lawyer discipline system and the State Bar Court to achieve the Fund's objectives - to come to the aid of those clients who have suffered a loss caused by a small number of errant lawyers.

The Fund is primarily financed by an annual assessment added to the membership dues paid by California lawyers (currently \$40 per active member and \$10 per inactive member). These assessments are applied only for the purposes of Fund payments and costs associated with the Fund's administration. Effective January 1, 2009, the Board of Governors increased the maximum payment to an applicant from \$50,000 to \$100,000 for losses occurring on or after January 1, 2009.

Although the filing rate for new applications has continued at a high rate due to loan modification losses, the Fund has responded by paying out on and processing more applications than ever before. In 2013, the number of applications filed declined from the height of the loan modification crisis to 2,228 new applications filed, which is still twice the historic average. The Fund paid \$11,054,352 on 1,999 applications in 2013. The most typical losses are failure to refund unearned fees when the lawyer performed no work, which includes losses caused by loan modification schemes.

Since its inception, the Fund has reimbursed applicants approximately \$121 million.

### Rules and Coverage

The Fund is governed by the Client Security Fund rules which were adopted by the Board of Governors (now Board of Trustees) and made effective for all applications filed on or after January 1, 2010. The new rules simplified the language but did not result in substantive changes of the Rules of Procedure, Client Security Fund Matters, which still apply to applications filed prior to January 1, 2010.

The rules set forth the scope and purpose of the Fund, the authority of the Client Security Fund

Commission, the requirements for reimbursement, the application process, the confidentiality of the Fund records, and judicial review of Commission decisions. An Applicant or Respondent lawyer may seek judicial review of a Final Decision of the Commission in the superior courts of the state under section 1094.5 of the Code of Civil Procedure.

## **Number of Applications Paid by Category**

In 2013, the Fund paid out \$11,054,352 on 1,999 awards. The largest number of applications paid was in the “Unearned Fees” category (93.5%). The remaining applications were in the “Misappropriation” category (6.5%).

### **Number of Applications Paid by Category in 2013**

Total: 1,999

1,870 Unearned Fees

129 Misappropriation

## **Dollar Amount of Applications Paid by Category**

In 2013, the largest number of applications paid and the largest dollar amount paid were in the “Unearned Fees” category, \$8,531,682 or approximately 77%. The remaining applications paid and the dollar amount paid were in the “Misappropriation” category totaling \$2,522,670 or approximately 23%.

### **Dollars Paid by Category in 2013**

Total: \$11,054,352

\$8,531,682 Unearned Fees

\$2,522,670 Misappropriation

## **General Basis for Reimbursement**

An applicant must establish a loss of money or property that was received by an active attorney who was acting as an attorney or in a fiduciary capacity customary to the practice of law, and which loss was caused by dishonest conduct as defined under the rules.

## **Rule of Limitations**

Applications for reimbursement from the Fund must be filed within four years after the applicant discovers or reasonably should have discovered the loss.

## Status of the Lawyer

In order for reimbursement to be paid, the lawyer whose dishonest conduct caused the loss must have been acting as a lawyer, or in a specified fiduciary capacity, such as the trustee of an express trust or as an escrow holder.

Also, the lawyer must have been disciplined, voluntarily resigned, died, been found mentally incompetent or been judged guilty of a crime that involved the loss.

## Dishonest Conduct

A lawyer's dishonest conduct that can lead to payment from the Fund includes:

- theft or embezzlement of money or the wrongful taking or conversion of money or property;
- failure to refund unearned fees received in advance when the lawyer performed an insignificant portion of the services or none at all;
- the borrowing of money from a client without the intention or the reasonable ability to repay it;
- obtaining money or property from a client for an investment when no investment is made; or
- an act of intentional dishonesty or deceit that proximately leads to the loss of the money or property.

## Losses not Covered

The Fund will not reimburse a loss if:

- it was covered by insurance, a bond or another fund;
- it was caused by negligence or malpractice; or
- it was a bad business loss such as a failed investment.

The Fund also does not cover interest, incidental or consequential losses or expenses caused by the attorney. Examples of incidental or consequential losses would include fees applicant paid to another attorney or damages caused by malpractice, negligence or incompetence.

## Legislation

Oversight of the Client Security Fund is provided by the Legislature through a series of statutes, and by the Bar's Board of Trustees.

The State Bar's authority to operate the Client Security Fund is found in Business & Professions Code section 6140.5. This Legislation, effective March 4, 1972, was a result of a Board resolution dated June 17, 1971 and a Bar-sponsored bill. Section 6140.5(a) requires the Board to maintain a Client Security Fund.

Effective January 1, 2006, Section 6140.5(a) was amended to expand the purpose of the Client Security Fund to include relieving or mitigating pecuniary losses caused by the dishonest conduct of Foreign Legal

Consultants registered with the State Bar and attorneys registered with the State Bar under the Multi-jurisdictional Practice Program.

Section 6140.5(b) provides a special statute of limitations whereby the Bar may bring an action to enforce its subrogation rights within three years of the date of payment to an applicant. Another part of the Bar's effort to collect against the errant lawyer is section 6140.5(c) which allows the Bar to add any CSF payout, plus interest and processing costs, to the membership dues bill of any lawyer who has been disciplined and which requires disbarred and resigned attorneys to repay the Fund as a condition to reinstatement.

Section 6140.5(d) allows certain fund payments to be enforced as money judgments pursuant to Division 2 (commencing with Section 695.010) of the Code of Civil Procedure.

Section 6140.55 currently allows the Board to assess annually up to \$40 per active member and \$10 per inactive member to support the Fund. This assessment is to be used only for the purposes of the Fund.

Section 6149.5 serves as an early loss prevention measure. It requires insurers to provide written notice to a claimant of settlement payments of \$100 or more delivered to the claimant's lawyer or other representative in settlement of any third-party liability claim.

Another statute that affects the Fund is section 473 of the Code of Civil Procedure. Under this section, when a court sets aside a default judgment due to a party or attorney's mistake, inadvertence, surprise or excusable neglect, it may (1) impose a penalty of no more than \$1,000, (2) direct the offending attorney to pay up to \$1,000 to the Client Security Fund, or (3) grant such other relief as appropriate. Under this statute, the Fund received \$15,799 in 2013.

## **Summary of Applications**

### **(Past 5 Years)**

#### **5-Year Summary of Number of Applications Filed**

2013	2,228
2012	2,767
2011	3,411
2010	3,875
2009	3,028

#### **5-Year Summary of Amounts Requested on Applications**

2013	\$24,205,412
2012	\$25,112,748
2011	\$26,086,578
2010	\$23,231,936
2009	\$19,469,661

### **5-Year Summary of Number of Applications Paid**

2013	1,999
2012	1,466
2011	1,534
2010	267
2009	378

### **5-Year Summary of Applications Paid in Dollars**

2013	\$11,054,352
2012	\$6,870,643
2011	\$7,819,854
2010	\$3,331,124
2009	\$3,461,950

### **Applications Resolved**

The 3,687 applications “Resolved” in 2013 include those paid, denied and withdrawn.

### **5-Year Summary of Applications Closed**

2013	3,687
2012	2,311
2011	2,178
2010	760
2009	741

### **5-Year Summary of Applications Pending**

At year-end 2013, 6,342 applications were pending, representing \$51,908,976 in requested funds.

### **5-Year Summary of Applications Pending at Year’s End**

2013	6,342
2012	7,801
2011	7,345
2010	6,112
2009	2,997

## Commission Members

Colleen Dietz,  
a public member, is a Director of Professional Development Programs, at USC. She was appointed in September 2009 and serves as Chair for 2013 -2014. Her term expires in September 2014.

Douglas J. Hartsough,  
an attorney member, is a sole practitioner in Brentwood in Northern California. He was appointed in November 2009. He is the Vice-Chair for 2013 - 2014. His term expires in September 2014.

Marife H. Bugtong,  
a public member, is currently retired. She formerly worked as a secretary in a law office specializing in Workers' Compensation. She was appointed in October 2012. Her term expires in October 2015.

Jeffrey Ian Golden,  
an attorney member, works at a private business litigation law firm. He was appointed in October 2013. His term expires in October 2016.

Jonathan Libby,  
an attorney member, is with the Office of the Federal Public Defender. He was appointed in September 2011. His term expires in September 2014.

Evangelyn Nathan,  
a public member, is a Commanding Officer in the Los Angeles Police Department in the West Los Angeles Police Station. She was appointed in October 2013. Her term expires in October 2016.

Wendy Wu,  
an attorney member, is a prosecutor for the US Attorney's Office in Los Angeles. She was appointed in November 2011. Her term expires in September 2014.

## Decision Making

Policy oversight of the Client Security Fund is a joint responsibility of the Board of Trustees and the Client Security Fund Commission. The seven member Commission acts as the Board's delegate in administering the Fund. The Commission has the sole and final authority to make determinations on applications.

The Board monitors the Fund through its appointment of seven commissioners; approval of recommended changes and additions to the Client Security Fund rules; consideration and approval of the Fund's annual administrative budget; and power to seek legislative authority to increase the lawyer's fees that support the Fund.

The Board exercises its authority as an entity and through its Regulation, Admissions & Discipline Oversight Committee.

Of the seven volunteer members who comprise the Commission, no more than four of them may be

lawyers. They are assisted by a professional staff who screen, analyze, investigate and present cases to the Commission.

Among the Commission's key functions are:

- deciding whether to grant or deny applications made to the Fund after written and oral presentation by CSF counsel;
- recommending to the Board of Trustees necessary staffing levels to carry out the Fund's business in a professional, timely fashion;
- taking steps to increase the efficiency and timeliness with which the Commission and staff process applications;
- monitoring the Fund balance and recommending necessary fee increases to guarantee its continued solvency;
- interpreting the Fund's rules through policy statements and recommending necessary amendments and additions; and
- providing for the efficient inner workings of the Commission itself.

## Financial Picture

To have a complete picture of the Fund's fiscal health, it is important not only to see what money is on hand and how much has been actually paid out, but to also know how much is expected to be paid on pending cases. This anticipated payout, is calculated by multiplying the total dollar amount of the pending cases times an estimated application payable ratio. The application payout ratio is based upon how much the Fund has historically paid for every dollar requested. For example, if the Fund has historically paid \$.30 for every \$1 requested, then the application payout ratio is 30 percent.

The application payout ratio used by the Fund is based upon a 24-month rolling average. The estimated future payments changes, not only with changes in the application payout ratio, but also as the total dollar amount of outstanding applications changes.

## Balance Sheet

The balance sheet shows the Fund's assets and liabilities as of December 31, 2013.

Fund assets are maintained in cash and cash equivalents.

Current estimates include estimated awards ultimately to be paid on applications which are pending as of December 31 plus next year's dues payments received early - for example, 2013 dues received in 2012.

The Fund balance or deficit is simply the difference between Fund assets and accrued liabilities.

## Statement Of Revenues, Expenses And Changes In Fund Balance

Total revenues consist of members' dues, interest income and other revenues such as Court ordered sanctions and occasional contributions.

Expenses include awards paid and administrative expenses. Awards constitute the major expense. Off-set against this expense are any monies recovered from the bar's collection activities. This is reflected as "Awards Reimbursements or Recovery."

The Estimated Decrease/(Increase) in Awards Payable is an adjustment made at the end of the year because of changes in the estimated future payments.

### 2013 BALANCE SHEET STATEMENTS

	AUDITED 12/31/13
ASSETS:	
Cash	\$7,196,226
LIABILITIES & FUND BALANCES:	
Current liabilities	\$1,620,684
Net Assets	\$5,575,542
Total liabilities& Fund balances	\$7,196,226

### 2013 STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND BALANCES

	AUDITED 12/31/13
REVENUES:	
Membership dues	\$7,440,360
Investment Income	\$28,596
Other/Miscellaneous Revenues	\$20,288
TOTAL REVENUES	\$7,489,244
EXPENSES:	
Awards Paid/Accrued	\$11,054,352
2013 Unclaimed Cases	(\$37,694)
	\$11,016,658
Less: Awards Reimbursements or	
Recovery	(\$294,991)
Deposit	(\$7,227)
Total	\$10,714,440
Administration	2,304,285
TOTAL EXPENSES	13,018,725
EXCESS (DEFICIT) OF REVENUES OVER EXPENSES	(\$5,529,481)
Net Assets, as of year-end	\$5,575,542

## Notes from Applicant 2013

"I would like to take this opportunity to thank you, the whole staff of the State Bar of California, and the Client Security Fund for the job that you do of helping people like me, it takes time from our busy lives but you deserve it..."

"Please accept my thanks and gratitude for a job well done and I thank you for those who are too busy and did not take the time to let you know we are blessed you are there."

"I am so thankful and appreciative of your service. Special "Thank You" to all the honest, professional and good attorneys/lawyers of California who makes this service available to victims of attorney theft."

"It is good to know that the State Bar of California has an organization to protect unsuspecting people from these kinds of situations. Thank you again, and thanks to all the honest attorneys who work so hard to protect their client's rights."

"We wanted to take the time to thank your organization and the California legal profession in general for your work and your diligence at bringing dishonest attorneys to justice. More than that you help the victims of these criminals and to that we cannot thank you enough or properly."

"We received a check from your office reimbursing us for money we lost through a lawyer in California. We are retired, on a fixed income and struggled since losing our money to him. You have restored our faith, you have lifted us up again, and you have shown us, again that there are good people. Thank you."

**Client Security Fund**  
**Nine Years Comparison**  
**2005-2013**

	2005		2006		2007		2008		2009		2010		2011		2012		2013	
	# of Applications	Amount (\$)																
Applications outstanding, begin of year	858	9,956,622	787	10,396,199	797	9,579,525	787	11,811,143	710	11,871,541	2,997	22,124,850	6,112	34,513,647	7,345	45,327,104	7,801	55,518,550
Prior year's outstanding application adjustment	(3)	90,040	(2)	241,984	0	69,048	0	107,497	0	15,532	0	100,260	0	194,064	0	108,564	0	243,482
New Applications	1,318	11,558,645	1,314	10,916,591	1,013	12,927,446	825	11,290,084	3,028	19,469,661	3,875	23,231,936	3,411	26,086,578	2,767	25,112,748	2,228	22,825,372
<b>TOTAL APPLICATIONS</b>	<b>2,173</b>	<b>21,605,307</b>	<b>2,099</b>	<b>21,554,774</b>	<b>1,810</b>	<b>22,576,019</b>	<b>1,612</b>	<b>23,208,724</b>	<b>3,738</b>	<b>31,356,734</b>	<b>6,872</b>	<b>45,457,046</b>	<b>9,523</b>	<b>60,794,289</b>	<b>10,112</b>	<b>70,548,416</b>	<b>10,029</b>	<b>78,587,404</b>
Less: Processed Applications:																		
Paid	982	4,648,584	943	5,299,061	607	4,352,110	479	4,638,272	378	3,461,950	267	3,331,124	1,534	7,819,854	1,466	6,870,643	1,999	11,054,352
Rejected	50	2,535,698	24	1,799,629	42	2,066,308	57	2,196,878	52	1,930,226	138	2,869,032	54	2,585,888	112	3,092,632	68	3,096,196
Withdrawn	354	4,024,826	335	4,876,559	374	4,346,458	366	4,502,033	311	3,839,708	355	4,743,243	590	5,061,443	733	5,066,591	1,620	13,907,920
<b>TOTAL PROCESSED APPLICATIONS</b>	<b>1,386</b>	<b>11,209,108</b>	<b>1,302</b>	<b>11,975,249</b>	<b>1,023</b>	<b>10,764,876</b>	<b>902</b>	<b>11,337,183</b>	<b>741</b>	<b>9,231,884</b>	<b>760</b>	<b>10,943,399</b>	<b>2,178</b>	<b>15,467,185</b>	<b>2,311</b>	<b>15,029,866</b>	<b>3,687</b>	<b>28,058,468</b>
Applications outstanding, end of year	787	10,396,199	797	9,579,525	787	11,811,143	710	11,871,541	2,997	22,124,850	6,112	34,513,647	7,345	45,327,104	7,801	55,518,550	6,342	50,528,936
Applications outstanding inc./(dec.) over beginning balance	(71)	439,577	10	(816,674)	(10)	2,231,618	(77)	60,398	2,287	10,253,309	3,115	12,388,797	1,233	10,813,457	456	10,191,446	(1,459)	(4,989,614)
Applications payout ratio		43.79%		42.86%		42.45%		40.68%		39.38%		33.67%		42.22%		48.17%		41.60%
Est. claims liability at payout ratio		4,552,496		4,105,784		5,013,830		4,829,343		8,712,766		11,620,745		19,137,103		26,743,285		21,020,037
Net Assets, end of year		1,479,897		2,325,593		2,990,889		4,304,519		2,678,965		2,322,315		(7,215,281)		(15,638,262)		(15,444,495)
Net Assets, end of year - cash basis		6,032,393		6,431,377		8,004,719		9,133,862		11,391,731		13,943,060		11,921,822		11,105,023		5,575,542