

The State Bar of California

Client Security Fund – 2014 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.

New application filings for 2014 remained higher than the historical average due to loan modification schemes, but the 1,554 applications filed is less than the number filed at the height of the loan modification crisis. The Fund continues to process and resolve a large volume of applications, and in 2014 paid \$9,031,386 on 1,152 applications. The most typical losses involve the 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 \$130 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 to 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 2014, the Fund paid out \$9,031,386 on 1,152 applications. The largest number of applications paid was in the “Unearned Fees” category (88.6%). The second largest number of applications paid was in the “Misappropriation” category (11%). Less than 1% of the applications paid were in the Loan and Other category.

Number of Applications Paid by Category in 2014

Total: 1,152

1,020	Unearned Fees
127	Misappropriation
5	Loan and Other

Dollar Amount of Applications Paid by Category

In 2014, the largest number of applications paid and the largest dollar amount paid were in the “Unearned Fees” category; \$5,258,739 or approximately 58% of the dollars paid were in this category. The second largest category for the dollar amount paid was in the “Misappropriation” category totaling \$3,688,217 or approximately 41% of the dollars paid.

Dollars Paid by Category in 2014

Total: \$9,031,386

\$5,258,739	Unearned Fees
\$3,688,217	Misappropriation
\$84,430	Loan and Other

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 establish that the 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.

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 reimbursement 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. 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 \$10,281 in 2014.

Summary of Applications

(Past 5 Years)

5-Year Summary of Number of Applications Filed

2014	1,554
2013	2,228
2012	2,767
2011	3,411
2010	3,875

5-Year Summary of Amounts Requested on Applications

2014	\$20,842,066
2013	\$22,825,372
2012	\$25,112,748
2011	\$26,086,578
2010	\$23,231,936

5-Year Summary of Number of Applications Paid

2014	1,152
2013	1,999
2012	1,466
2011	1,534
2010	267

5-Year Summary of Applications Paid in Dollars

2014	\$ 9,031,386
2013	\$11,054,352
2012	\$ 6,870,643
2011	\$ 7,819,854
2010	\$ 3,331,124

Applications Resolved

The 2,222 applications “Resolved” in 2014 include those paid, denied and withdrawn.

5-Year Summary of Applications Closed

2014	2,222
2013	3,687
2012	2,311
2011	2,178
2010	760

5-Year Summary of Applications Pending

At year-end 2014, 5,674 applications were pending, representing \$46,703,719 in requested funds.

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

2014	5,674
2013	6,342
2012	7,801
2011	7,345
2010	6,112

2014 – 2015 Commission Members

Douglas J. Hartsough,
an attorney member, is a sole practitioner in Brentwood in Northern California. He was appointed in November 2009. He is the Chair for 2014 - 2015. His term expires in October 2015.

Jonathan Libby,
an attorney member, is with the Office of the Federal Public Defender. He was appointed in September 2011. He is the Vice-Chair for 2014 – 2015. His term expires in October 2015.

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.

Robert C. Harbicht,
a public member, is currently the retired President of a market research company. He was appointed in September 2014. His term expires in September 2017.

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.

Etan E. Rosen,
an attorney member, is a managing partner of a law firm in Sacramento. He was appointed in September 2014. His term expires in September 2017.

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 conduct legal analysis, screen, investigate and present cases to the Commission. CSF staff reports to Colin Wong, the Chief Administrative Officer of the State Bar Court.

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 payout 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 change, 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, 2014.

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, 2014 dues received in 2013.

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 reimbursements paid and administrative expenses. Reimbursements constitute the major expense. Off-set against this expense are any monies recovered from the bar's collection activities.

2014 BALANCE SHEET STATEMENTS

	AUDITED 12/31/14
ASSETS:	
Cash	\$3,921,130
LIABILITIES & FUND BALANCES:	
Current liabilities	\$1,712,576
Net Assets	\$2,208,554
Total Liabilities & Fund Balances	\$3,921,130

2014 STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND BALANCES

	AUDITED 12/31/14
REVENUES:	
Membership dues	\$7,581,531
Investment Income	\$18,418
Other/Miscellaneous Revenues	\$14,301
TOTAL REVENUES	\$7,614,250
EXPENSES:	
Reimbursements Paid	\$9,031,386
Less: Amounts Recovered	(\$478,819)
Total	\$8,552,567
Administration	2,428,670
TOTAL EXPENSES	10,981,237
EXCESS (DEFICIT) OF REVENUES OVER EXPENSES	(\$3,366,987)
Net Assets, as of year-end	\$2,208,554

2014 Quotes from Applicant

“Thanks so much! And would like to add too, it is nice to know there are people like you! I appreciate your assistance.”

“Just a note to let you know we received and thank you for the check in the amount of \$5,500.00. We appreciate the refund so much and are very pleased with the outcome. Again, thank you from bottom of our hearts for protecting us from the dishonest lawyers !!

“I wanted to send you this letter of thanks and sincere gratitude for sending our family a check of \$5,000 from the Client Security Fund to reimburse us for the money taken from us by Respondent when he abandoned his practice in Chino. I am so grateful that the Client Security Fund exists for people like us. In fact, I have thanked every attorney that I have seen in passing for paying their dues to this important fund.”

“I would like to congratulate all of you for renewing my faith in the judicial system, and the Attorney trust that you have portrayed to me and my family.”

“Thank you so much for the time that you put into this case. We received our reimbursement check for the full amount \$2,995. We appreciate you helping us to recover our loss. We cannot thank you enough for what you did.”

“We thank you for your Job Well Done. Justice has prevailed. We pray and hope for the other victims that they may get the same result. We thank you again for your team CLIENT SECURITY FUND. For the great efforts, persistence and keeping us informed.”

“The “good” lawyers of California paying for the dishonest lawyers’ harmful antics is very commendable. I really appreciate your help. Everyone I dealt with was very friendly. With my husband being disabled the return of our money is very helpful and needed. God Bless you all! Thanks again.”

“We are pleased to inform you that we already received the reimbursement from the Client Security Fund on the amount of \$3,495.00. Your assistance and immediate action regarding this matter is greatly appreciated.”

**STATE BAR OF CALIFORNIA
CLIENT SECURITY FUND
NINE YEARS COMPARISON
2006 - 2014**

	2006		2007		2008		2009		2010		2011		2012		2013		2014	
	# of Applications	Amount	# of Applications	Amount	# of Applications	Amount	# of Applications	Amount	# of Applications	Amount	# of Applications	Amount	# of Applications	Amount	# of Applications	Amount	# of Applications	Amount
Applications outstanding, begin 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
Prior year's outstanding application adjustment	(2)	241,984	-	69,048	-	107,497	-	15,532	-	100,260	-	194,064	-	108,564		243,483		596,474
New Applications	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	1,554	20,842,066
TOTAL APPLICATIONS	2,099	21,554,774	1,810	22,576,019	1,612	23,208,724	3,738	31,356,734	6,872	45,457,046	9,523	60,794,289	10,112	70,548,416	10,029	78,587,404	7,896	71,967,476
Less: Processed Applications:																		
Paid	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	1,152	9,031,386
Rejected	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	116	4,575,621
Withdrawn	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	954	11,656,750
TOTAL PROCESSED APPLICATIONS	1,302	11,975,249	1,023	10,764,876	902	11,337,183	741	9,231,884	760	10,943,399	2,178	15,467,185	2,311	15,029,866	3,687	28,058,468	2,222	25,263,757
Applications outstanding, end of year	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	5,674	46,703,719
Applications outstanding inc./(dec.) over beginning balance	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)	(668)	(3,825,217)
Applications payout ratio		42.86%		42.45%		40.68%		39.38%		33.67%		42.22%		48.17%		41.60%		37.68%
Est. applications payouts		\$4,105,784		\$5,013,830		\$4,829,343		\$8,712,766		\$11,620,745		\$19,137,103		\$26,743,285		\$21,020,037		\$17,597,961
Net Assets, end of year		\$2,325,593		\$2,990,889		\$4,304,519		\$2,678,965		\$2,322,315		(\$7,215,281)		(\$15,638,262)		(\$15,444,495)		(\$15,389,407)
Net Assets., end of year - cash basis		6,431,377		8,004,719		9,133,862		11,391,731		13,943,060		11,921,822		11,105,023		5,575,542		2,208,554