

The State Bar of California  
Client Security Fund - 2011 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 very high rate due to loan modification losses, the Fund has responded by paying out on and processing more applications than ever before. Since its inception, the Fund has reimbursed applicants approximately \$103.8 million. In 2011, the Fund paid \$7,819,854 on 1,534 awards. The most typical losses reported are theft of client personal injury settlement funds and failure to refund fees when the lawyer performed no work, which includes losses caused by the loan modification schemes. Despite processing more cases in one year than ever before, on December 31, 2011, the Fund had 7,345 applications pending as compared to 6,112 pending at year end 2010 and 2,997 at year end 2009. The Client Security Fund estimates that approximately 87% of the pending cases are based on loan modification losses.

### Rules and Coverage

The Fund is governed by the Client Security Fund rules which were adopted by the Board of Governors 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 2011, the Fund paid out \$7,819,854 on 1,534 awards.

The largest number of applications paid was in the "Unearned Fees" category (76.7%). The second largest category by size was the "Misappropriation" category (22.9%) with "Loans" and "Investments" representing less than 1% of the applications paid.

### Number of Applications Paid by Category in 2011

Total: 1,534

1,177 Unearned Fees

3 Loans  
352 Misappropriation  
2 Investments

#### Dollar Amount of Applications Paid by Category

In 2011, the largest number of applications paid and the largest dollar amount paid were in the “Unearned Fees” category, \$4,842,101 or approximately 61.9%. “Misappropriation” cases comprised the second largest dollar amount of applications paid, \$2,673,053 or approximately 34.2%. The remaining small percent of the total payouts were for “Loans” and “Investments.”

#### Dollars Paid by Category in 2011

Total: \$7,819,854  
\$2,673,053 Misappropriation  
\$254,700 Loans  
\$50,000 Investments  
\$4,842,101 Unearned Fees

#### General Basis for Reimbursement

An applicant must establish a loss of money or property that was received by an active attorney or an attorney acting in a fiduciary capacity customary to the practice of law, and which loss was caused by a dishonest act 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 through the Client Security Fund rules.

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 \$25,150 in 2011.

Summary of Applications  
(Past 5 Years)

5-Year Summary of Number of Applications Filed

2011	3,411
2010	3,875
2009	3,028
2008	825
2007	1,013

5-Year Summary of Amounts Requested on Applications

2011	\$26,086,578
2010	\$23,231,936
2009	\$19,469,661
2008	\$11,290,084
2007	\$12,927,446

5-Year Summary of Number of Applications Paid

2011	1,534
2010	267
2009	378
2008	479
2007	607

5-Year Summary of Applications Paid in Dollars

2011	\$7,819,854
2010	\$3,331,124
2009	\$3,461,950
2008	\$4,638,272
2007	\$4,352,110

Applications Closed

The 2,178 applications "Closed" in 2011 include those paid, denied and withdrawn.

5-Year Summary of Applications Closed

2011	2,178
2010	760
2009	741
2008	902
2007	1,023

5-Year Summary of Applications Pending

At year-end 2011, 7,345 applications were pending, representing \$45,327,104 in requested funds.

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

2011	7,345
2010	6,112
2009	2,997
2008	710

### Commission Members

Howard Caldwell,

a public member, is a self-employed consultant in labor management relations. He was appointed in September 2008 and serves as Chair for 2011-2012. His term expires in September 2012.

Linda Monroe,

an attorney member, is currently a sole practitioner. She was appointed in September 2009 and serves as Vice Chair for 2011-2012. Her term expires in September 2012.

Colleen Dietz,

a public member, is a Director of Professional Development Programs, at USC. She was appointed in September 2009. Her term expires in September 2012.

Douglas J. Hartsough,

an attorney member, is currently a sole practitioner in Brentwood in Northern California. He was appointed in November 2009. His term expires in October 2013.

Jonathan Libby,

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

Wendy Wu,

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

Paula Solomon,

a public member, is currently a volunteer for the Registrar of the Peoples College of Law. She was appointed in September 2011. Her term expires in October 2013.

### 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 of 9 who screen, analyze, investigate and present cases to the Commission. 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 and, occasionally, after hearing held before the Commission;
- 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 to the Board of Trustees 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, or accrued liability, is calculated by multiplying the total dollar amount of the pending cases times an estimated claims payable ratio. The claims payable 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 claims payable ratio is 30 percent.

The claims payable ratio used by the Fund is based upon a 24-month rolling average. The accrued liability changes, not only with changes in the claims payable 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, 2011.

Fund assets are maintained in cash and cash equivalents.

Current liabilities 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, 2011 dues received in 2010.

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, accrued liabilities 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 Liability is an adjustment made at the end of the year because of changes in the accrued liability.

2009 - 2011 BALANCE SHEET STATEMENTS

	AUDITED 12/31/09	AUDITED 12/31/10	UNAUDITED 12/31/11
<b>ASSETS:</b>			
Cash	11,474,262	15,522,370	13,500,746
<b>LIABILITIES &amp; FUND BALANCES:</b>			
Current liabilities	8,795,297	13,200,055	20,716,027
Net Assets	2,678,965	2,322,315	(7,215,281)
Total liabilities & Fund balances	11,474,262	15,522,370	13,500,746

2009 - 2011 STATEMENT OF  
REVENUES, EXPENSES AND CHANGES IN FUND BALANCES

	AUDITED 12/31/09	AUDITED 12/31/10	UNAUDITED 12/31/11
<b>REVENUES:</b>			
Membership dues	6,872,572	6,983,974	7,122,097
Investment Income	145,501	79,494	54,633
Other/Miscellaneous Revenues	6,500	17,120	25,870
<b>TOTAL REVENUES</b>	<b>7,024,573</b>	<b>7,080,589</b>	<b>7,202,601</b>
<b>EXPENSES:</b>			
Awards Paid/Accrued	7,343,982	6,235,638	15,334,597
Less: Awards Reimbursements or Recovery	(615,485)	(418,964)	(461,631)
CSF Claims Collection Exp.	62,933	2,109	16,247
Total	6,791,431	5,818,783	14,889,214
Administration	1,858,696	1,618,456	1,850,983
<b>TOTAL EXPENSES</b>	<b>8,650,127</b>	<b>7,437,239</b>	<b>16,740,197</b>
<b>EXCESS (DEFICIT) OF REVENUES OVER EXPENSES</b>	<b>(1,625,554)</b>	<b>(356,650)</b>	<b>(9,537,596)</b>

Estimated Decrease / (Increase)

in Awards Payable Liability	(3,883,423)	(2,907,979)	(7,516,358)
Net Assets, as of year-end	2,678,965	2,322,315	(7,215,281)

#### Quotes from Applicant 2011

“Thank you so much for your help and giving me back the money. More power to all of you! I just can’t thank you enough! You’re great!”

“I wish to express my sincere gratitude for your decision in my case. It was a very pleasant surprise when I received the check.”

“Thank you from the bottom of our hearts.”

“I am in receipt of the reimbursement check and again express my profound thanks for your positive response to a financial experience that was proven to be devastating.”