

The State Bar of California

Client Security Fund - 2004 Activities Report

Public Protection Program

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.

Financed by a \$35 annual assessment added to the membership dues paid by California lawyers, the Fund reimburses eligible applicants up to \$50,000.00. Since its inception, the Fund has reimbursed applicants approximately \$68 million. In 2004, the Fund paid \$5,681,455 on 746 awards. The most typical losses reported are theft of client personal injury settlement funds and the refusal to refund fees when the lawyer performs no work.

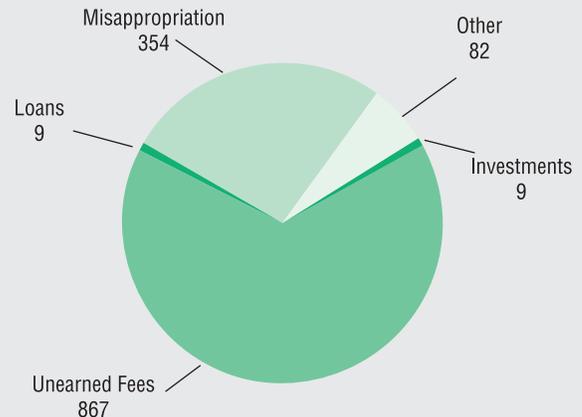
The Fund provides the legal profession with a unique opportunity to promote public confidence in the administration of justice and the integrity of the legal profession. It is also a cost-effective way of providing reimbursement to victims that is generally not available from any other source. The Client 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.

In 2004, the Fund received 1,321 new applications—the most ever received in one year. As the chart below reflects, the filing rate for new applications dropped significantly in 1998-99 due to the virtual shutdown of the discipline system during the fee bill crisis (i.e. June 1998 through March 1999). However, since the year 2000, the filing rates for new applications have continued to rise.



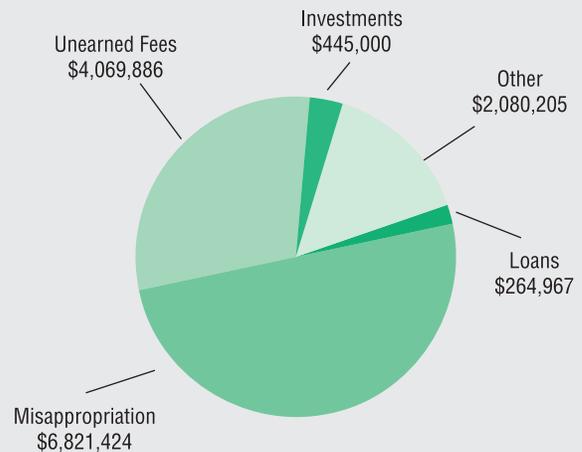
Number of Applications Filed by Category in 2004 Total: 1,321

The largest number of applications filed was in the "unearned fees" category (65.6%). The second largest number of applications filed was in the "misappropriation" category (26.8%).



Dollar Amount of Applications Filed by Category in 2004 Total: \$13,681,482

While "unearned fee" cases comprised the largest number of applications filed, "misappropriation" cases comprised the largest dollar losses reported. Unearned fee cases represented approximately 29.8 percent of all dollar losses reported. Misappropriation cases represented approximately 49.9 percent of all losses reported.



"I really can't thank you enough for having a wonderful program available to those of us who have been taken advantage of and abused by those who are supposed to be looking out for our best interests."
(Quote from Applicant 2004)

Legislation

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

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.

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 or resigns with discipline matters pending and seeks to be reinstated.

Effective January 1, 2004, 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 allows the Board to assess up to \$35 per active 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 \$35,423 in 2004.

Rules and Coverage

The Fund is governed by the Rules of Procedure, Client Security Fund Matters which were adopted by the Board of Governors on December 21, 1985. Under these Rules, a seven-member Commission, appointed by the Board, acts as the Board's delegate in administering the Fund. From time to time, the Commission recommends to the Board amendments to the Rules of Procedure. Proposed rule changes are circulated for public comment before final action is taken by the Board.

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

General Basis for Reimbursement

An applicant must establish the loss of money or property which came into the hands of an active member of the State Bar while acting as a lawyer, trustee or fiduciary as defined in the Rules of Procedure, Client Security Fund Matters, 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. The Rules do give the Commission the discretion to waive this requirement under certain limited circumstances - for example, in clear cases when formal charges have been filed but the lawyer has not yet been disciplined.

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;
- refusal to refund unearned fees received in advance where the lawyer performed no services or an insignificant part of the services contracted for such that the lawyer can be regarded as having lacked the intention to perform at the time payment was received;
- the borrowing of money from a client without the intention or the reasonably anticipated ability to repay it;
- obtaining money or property from a client by representing that it would be used for investment purposes when no investment is made; or
- an act of intentional dishonesty or deceit which directly 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.

Maximum Payment

The maximum allowable payment to an individual applicant is \$50,000 for covered losses. However, there is no limitation on the aggregate amount paid against a Respondent attorney.

"Thank you the staff at the Client Security Fund for the prompt and efficient processing of our client's application. This is certainly a credit to the work by the staff at the Client Security Fund Commission."

(Quote from Applicant's Counsel 2004)

Applications Paid by Category

In 2004, the Fund paid out \$5,681,455 on 746 awards.

The largest number of applications paid was in the "unearned fees" category (74.7%). The second largest category by size was "misappropriation" (24%) with "loans" and "investments" representing only a few of the applications paid.

Number of Applications Paid by Category in 2004 Total: 746

Unearned Fees	557
Misappropriation	180
Loans	4
Investments	5

5-Year Summary of Applications Paid

2004	746
2003	701
2002	782
2001	609
2000	595

"Many, many thanks for the nice check. I just thought it not possible."
(Quote from Applicant 2004)

Dollars Paid by Category

In 2004, "misappropriation" cases represented the largest dollar amount of applications paid. \$3,256,017.07, or approximately 57.31 percent, of all dollars paid out were in the "misappropriation" category. "Unearned fee" cases represented 36.35 percent of all dollars paid out with "loans" and "investments" representing a few percent of the total payouts.

Dollars Paid by Category in 2004 Total: \$5,681,455

Unearned Fees	\$2,065,250
Misappropriation	\$3,256,017
Investments	\$240,000
Loans	\$120,188

5-Year Summary of Applications Paid in Dollars

2004	\$5,681,455
2003	\$5,859,620
2002	\$6,597,057
2001	\$4,435,212
2000	\$3,674,000

"Once again we would like to thank all that helped recuperate our lost funds."
(Quote from Applicant 2004)

Applications Closed

The 1,209 applications "closed" in 2004 include those that are paid, rejected and withdrawn.

5-Year Summary of Applications Closed

2004	1209
2003	1209
2002	1286
2001	1069
2000	1095

"Please accept my sincere thanks to you and your staff. You have no idea how this has helped me in a time when money and trust were a rare commodity."
(Quote from Applicant 2004)

Applications Pending

The year 2004 closed with 858 applications pending, representing \$9,956,622 in reported losses.

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

2004	858
2003	759
2002	770
2001	751
2000	708

Commission Members



Joanne M. Guzman-Hays, is currently a voluntarily inactive attorney member, is a volunteer judge pro tem and former attorney for Legal Aid. She was appointed in September 2001 and serves as Chair for 2004-2005. Her term expires in September 2005.



Richard F. Lyon, an attorney member, is currently a sole practitioner in El Cerrito, after 31 years in practice both in law firms and as an in-house corporate counsel. He was appointed in September 2003. His term expires in October 2006.



Donna C. Riegel, an attorney member, is currently a sole practitioner in Pasadena with extensive and varied civil litigation experience. She is a volunteer temporary judge with the Los Angeles County Superior Courts. She was appointed in October 2004. Her term expires in September 2007.



Lauren J. Weil, an attorney member, worked as a criminal defense attorney for 15 years. She is not currently practicing but is involved in a number of volunteer activities. She was appointed in October 2002. Her term expires in October 2006.



Phyllis M. Crittenden, a public member, is an employee with the Los Angeles Unified School District. She was appointed in October 2002 and serves as Vice Chair for 2004-2005. Her term expires in September 2005.



Constance A. McClendon, a public member, is a retired Senior Enforcement Investigator for the U.S. Equal Employment Opportunity Commission. She was appointed in October 2002. Her term expires in September 2005.



Margarita Vazquez-Gomez, a public member, is a Division Manager for the Los Angeles County Internal Services Department. She was appointed in October 2002. Her term expires in September 2005.

"The Client Security Fund program was of tremendous benefit in continuing my life..."
(Quote from Applicant 2004)

"From the bottom of our hearts, we thank you again for your help and understanding."
(Quote from Applicant 2004)

"Your organization is performing a worthwhile service that is very much appreciated."
(Quote from Applicant 2004)

"Thank you for your perseverance in this matter...your program has been of great assistance to me."
(Quote from Applicant 2004)

Decision Making

Policy oversight of the Client Security Fund is a joint responsibility of the Board of Governors and the Client Security Fund Commission.

The Board monitors the Fund through its: appointment of seven commissioners; approval of recommended changes and additions to the Rules of Procedure; 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, and Discipline Oversight Committee (RAD).

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 is subject to Management oversight and in 2004 reported to Scott J. Drexel, the Administrative Officer for State Bar Court/Chief Court Counsel.

Among the Commission's key functions are:

- determining applications made to the Fund after a written and oral presentation of the matter by CSF staff and, occasionally, after hearing held before the Commission;
- recommending to the Board of Governors 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 Governors necessary fee increases to guarantee its continued solvency;
- interpreting the Rules of Procedure through policy statements and recommending necessary amendments and additions; and
- providing for the efficient inner workings of the Commission itself.



THE STATE BAR OF CALIFORNIA

Client Security Fund
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(213) 765-1140
www.calbar.ca.gov
Discipline Complaint Hotline: (800) 843-9053

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 claimed. For example, if the Fund has historically paid \$.30 for every \$1 claimed, 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, 2004.

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, 2004 dues received in 2003.

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 contributions.

Expenses include awards paid, accrued liabilities and administrative expenses. Awards constitute the major element. 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 a change in the accrued liability.

*"Thank you for your expeditious and kind attention to my case."
(Quote from Applicant 2004)*

*"It is with great appreciation that I am writing this letter of my thanks to your employees. You and your staff are an excellent example of what the justice system should be and all too often is not."
(Quote from Applicant's Counsel 2004)*

2002 - 2004 BALANCE SHEET STATEMENTS

	12/31/02	12/31/03	12/31/04
ASSETS:			
Cash	11,606,160	9,418,980	7,864,531
LIABILITIES & FUND BALANCES:			
Current liabilities	5,949,876	5,115,372	5,635,076
Fund balances	5,656,284	4,303,608	2,229,455
Total liabilities & Fund balances	11,606,160	9,418,980	7,864,531

2002 - 2004 STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND BALANCES

	12/31/02	12/31/03	12/31/04
REVENUES:			
Membership dues	4,852,118	4,588,189	4,802,923
Investment Income	246,996	129,240	115,733
TOTAL REVENUES	5,099,114	4,717,429	4,918,656
EXPENSES:			
Awards Paid/Accrued	7,830,169	5,149,225	6,150,467
Less: Awards Reimbursements or Recovery	(715,136)	(609,340)	(679,490)
Total	7,115,033	4,539,885	5,470,977
Administration	1,350,232	1,530,220	1,519,632
TOTAL EXPENSES	8,465,265	6,070,105	6,990,609
EXCESS (DEFICIT) OF REVENUES OVER EXPENSES	(3,366,151)	(1,352,676)	(2,071,953)
Estimated Decrease (Increase) in Awards Payable Liability			
	(1,277,273)	838,355	499,879
Fund Balances, as of year-end	5,656,284	4,303,608	2,229,455

CLAIMS ACTIVITY 1996 - 2004

Nine-year Comparison

	1996		1997		1998		1999		2000		2001		2002		2003		2004	
	Claims	Amount	Claims	Amount	Claims	Amount												
Claims outstanding, beg. of year	1,197	\$17,354,678	1,236	\$16,306,378	1,223	\$15,849,180	913	\$12,270,996	758	\$10,345,650	708	\$8,803,264	751	\$9,517,404	770	10,157,007	759	8,545,576
Prior year's outstdg. claim adj. inc.	0	159,580	0	116,345	16	339,685	1	101,840	(4)	(10,043)	(2)	110,553	5	\$29,491	(2)	55,611	(13)	114,750
New claims	1,082	12,364,140	1,217	12,717,110	652	7,879,099	611	6,780,932	1,049	10,929,128	1,114	11,900,739	1,300	14,166,217	1200	12,221,905	1321	13,681,482
TOTAL CLAIMS	2,279	\$29,878,398	2,453	\$29,139,833	1,891	\$24,067,964	1,525	\$19,153,768	1,803	\$21,264,735	1,820	\$20,814,556	2,056	\$23,713,112	1968	22,434,523	2067	22,341,808
Less: Processed Claims:																		
Paid	578	5,539,449	708	4,660,614	517	3,627,082	387	2,811,090	595	3,673,850	609	4,435,212	782	6,597,057	701	5,859,620	746	5,681,455
Rejected	90	3,206,604	73	2,982,725	74	2,414,893	69	1,883,065	132	4,061,716	68	2,903,338	39	2,580,784	39	2,585,959	39	1,701,671
Withdrawn	375	4,825,966	449	5,647,314	387	5,754,992	311	4,113,963	368	4,725,923	392	3,958,602	465	4,378,264	469	5,440,368	424	5,000,210
TOTAL PROCESSED CLAIMS	1,043	\$13,572,019	1,230	\$13,290,653	978	\$11,796,967	767	\$8,808,118	1,095	\$12,461,489	1,069	\$11,297,152	1,286	13,556,105	1,209	13,885,947	1209	12,383,336
Claims outstanding, end of year	1,236	16,306,379	1,223	15,849,180	913	12,270,996	758	10,345,650	708	8,803,264	751	9,517,404	770	10,157,007	759	8,548,576	858	9,956,622
Claims outstanding inc./(dec.) over beginning balance	39	(1,207,880)	(13)	(573,543)	(326)	(3,917,869)	(156)	(2,027,186)	(50)	(1,542,386)	43	714,140	19	639,603	(11)	(1,608,431)	99	1,411,046
Claims payout ratio		37.79%		37.90%		32.97%		31.76%		30.20%		33.75%		44.20%		45.26%		43.88%
Est. claims liability at payout ratio		\$6,162,181		\$6,006,839		\$4,045,747		\$3,285,778		\$2,658,586		\$3,212,124		\$4,489,397		\$3,869,086		\$4,368,966
FUND BALANCE (end of year)		\$14,972		\$262,515		\$3,417,414		\$6,607,930		\$8,981,524		\$9,022,435		\$5,650,779		\$4,303,608		\$2,229,455
FUND BALANCE (end of year, cash-basis)		\$6,177,153		\$6,269,354		\$7,444,022		\$9,902,786		\$11,640,110		\$12,234,559		\$10,140,176		\$8,172,695		\$6,598,421