MASLON EDELMAN BORMAN & BRAND

3300 NORWEST CENTER
MINNEAPOLIS, MINNESOTA 55402-4140

(612) 672-8200
FAX (612) 672-8397

WRITER'S DIRECT DIAL:
(612) 672-8350

August 24, 1993

Mr. Frederick K. Grittner
Clerk of Appellate Courts
245 Minnesota Judicial Center
25 Constitution Avenue
Saint Paul, Minnesota 55155-6102

RE: Amendment of the Rules of the Supreme Court for Registration of Attorneys and Rules of the Client Security Board
Nos. C9-81-1206 & C0-85-2205

Dear Mr. Grittner:

I am enclosing for filing an original and 14 copies of the Petition of Minnesota State Bar Association's Amendment of the Rules of the Supreme Court for Registration of Attorneys and Rules of the Client Security Board. In accordance with a conversation with your office last week, I have placed two file numbers on this Petition, one being the file number relating to the Rules for Registration of Attorneys and the other being the file number for Rules for the Client's Security Board.

If you have any questions, please let me know.

Thank you for your attention to these matters.

Yours very truly,

David F. Herr

DFH:psp
Enclosures

cc: Roger Stageberg
Merritt Marquardt
Tim Groshens
Mary Jo Ruff

STATE OF MINNESOTA
IN SUPREME COURT
Nos. C9-81-1206 & C0-85-2205

In re:

Amendment of the Rules of the Supreme Court for Registration of Attorneys and Rules of the Client Security Board

PETITION OF MINNESOTA STATE BAR ASSOCIATION

Petitioner Minnesota State Bar Association ("MSBA") respectfully petitions this Honorable Court to amend the Rules of the Supreme Court for Registration of Attorneys and Rules of the Minnesota Client Security Board.

1. Petitioner Minnesota State Bar Association ("MSBA") is a not-for-profit corporation of attorneys authorized to practice before this Honorable Court and the other courts of this state.

2. This Honorable Court has the exclusive and inherent power and duty to administer justice and to adopt rules of practice and procedure before the courts of this state and to establish the standards for regulating the legal profession. This power has been expressly recognized by the Legislature. See Minn. Stat. § 480.05 (1992).

3. This Honorable Court has adopted the Rules of the Supreme Court for Registration of Attorneys and the Rules of the Minnesota Client Security Board. Pursuant to those rules, this Honorable Court has jurisdiction and control over the Client Security Fund ("Fund") and the administration of the Fund.

4. In 1987 this Honorable Court amended the Rules of the Supreme Court for Registration of Attorneys to assume jurisdiction over the Fund. Theretofore, the Fund had been administered as a voluntary fund created and established by Petitioner MSBA. At the time the Court assumed jurisdiction over the Fund, it promulgated the Rules of the Minnesota Client Security Board. See Order Creating the Minnesota Client Security Board, No. C0-85-2205 (Minn., Apr. 15, 1986).

5. In 1990 this Honorable Court amended Rule 2 of the Rules of the Supreme Court for Registration of Attorneys. This order also directed the Petitioner, as well as the Client Security Board, to "continue to monitor these rules and amendments and [to] explore ways of permanently financing the Client Security Fund." See In re Amendments to the Rules of the Supreme Court for Registration of Attorneys, No. C9-81-1206 (Minn., Nov. 14, 1990).

6. Pursuant to the 1990 Order, in early 1991 the MSBA established a Client Protection Committee ("MSBA Committee") to consider issues and problems arising under the existing Rules governing the administration and financing of the Fund. The MSBA Committee studied these issues in detail, met at least eleven times between early 1991 and early 1993, and issued its Report of the Client Protection Committee ("Report") on January 29, 1993. A true and correct copy of this Report is attached to this Petition as Exhibit A and by this reference is made part hereof.

7. The MSBA accepted the Report and resolved to carry out its recommendations by action of its Board of Governors on April 24, 1993, and of its General Assembly on June 24, 1993, at its annual convention. This Petition was authorized and endorsed at that time.

8. The MSBA respectfully recommends and requests this Court to amend the Rules of the Supreme Court for Registration of Attorneys and the Rules of the Minnesota Client Security Board as follows:

a) Rule 2 of the Rules of the Supreme Court for Registration of Attorneys should be amended to retain the existing language of the rule but to delete the provision of the order adopting the rule that causes the $20.00 fee to be collected only until July 1, 1995. See Order, In re Amendments to the Rules of the Supreme Court for Registration of Attorneys, No. C9-81-1206, ¶ 5 (Minn., Nov. 14, 1990). Petitioner requests that the fee be collected permanently, pending further order of the Court and that the Minnesota Client Security Board be directed to advise the Court in the Board's annual report when the Fund's reserve account reaches $2,500,000 in value.

This amendment is requested to implement Recommendation 1 of the Report.

b) Rule 3.14 of the Rules of the Minnesota Client Security Board should be amended to add a new subdivision (c) as follows:

RULE 3.14 DETERMINATION

* * *

c. The maximum amount that may be paid to any claimant for a single claim is $100,000. In exceptional circumstances, the Board may allow a greater or lesser amount based on the factors set forth in subdivision (b) of this rule.

This amendment is requested to implement Recommendation 2 of the Report and is intended both to establish and modify the $50,000 payment cap that has been traditionally followed by the Board and to increase that cap to $100,000. Heretofore the Board has followed the practice of not paying more than $50,000 on any one claim, but this practice is an unwritten rule. Petitioner respectfully submits it should be made explicit as well as increased in amount to $100,000.

c) Rule 3.14 of the Rules of the Minnesota Client Security Board should be amended to add a new subdivision (d) as follows:

RULE 3.14 DETERMINATION

* * *

d. The Board may award interest on any award at the rate of interest payable on judgments on a discretionary basis from the date of filing the claim. In determining the amount of interest, if any, the Board may consider:

(1) The length of time between filing the claim and its disposition;

(2) The existence of third-party litigation; and

(3) Other factors outside the control of the Board.

This recommendation is made to implement Recommendation 3 of the Report.

9. Petitioner considered, but recommends no action on, suggestions that the rules be amended to provide for mandatory judicial review of Client Security Board decisions. The reasons for this recommendation are set forth in the Report at 90-91.

10. In addition to the foregoing rule amendments, Petitioner respectfully urges this court to consider appointment, from time to time, of an attorney from the public service sector as one of the lawyer members of the Client Security Board.

Based upon the foregoing authorities and the Report attached as Exhibit A, Petitioner Minnesota State Bar Association respectfully requests that this Honorable Court implement the rules amendments proposed in Paragraph 8, above and to take the further action regarding appointments to the Client Security Board as set forth in Paragraph 10.

Date: This ___ day of August, 1993.

Respectfully submitted,

MINNESOTA STATE BAR ASSOCIATION

By _____
Roger V. Stageberg
Its President

and

MASLON EDELMAN BORMAN & BRAND

By _____
David F. Herr (#44441)
3300 Norwest Center
90 South Seventh Street
Minneapolis, Minnesota 55402
(612) 672-8350

ATTORNEYS FOR PETITIONER
MINNESOTA STATE BAR ASSOCIATION

Adopted by the MSBA Board of Governors on April 24, 1993 and by the MSBA General Assembly on June 25, 1993.

REPORT

of the

CLIENT PROTECTION COMMITTEE

* * *

January 29, 1993

* * *

The Committee
Judge Terry Dempsey
Bert Greener
Mary Eichhorn-Hicks
Melvin Orenstein
Justice Peter Popovich
Allen Saeks
Donald Weinke

Merritt Marquardt
Chair
Mary Jo Ruff
MSBA Staff

EXHIBIT A

CLIENT PROTECTION COMMITTEE
REPORT

I.

Introduction

Statement of Purpose

Committee Members and Background

Meetings and Guest Speakers

II.

History of the Client Security Fund

Created by MSBA in 1963

Transferred to Supreme Court in 1987

Annual Assessment

III.

Issues

Discussion of Lawyer Substance Abuse and Defalcation

A. Funding Sources
- Lawyer assessments
- Bonding and insurance
- IOLTA funding

B. Payment Issues

C. Client Security Board Operations
- Composition of Board membership
- Judicial review
- Board rules and policies

D. Prevention Issues
- Client education
- Attorney education
- Random audits
- Double signature and insurance company notification

IV.

Recommendations

CLIENT PROTECTION COMMITTEE REPORT

I.

Introduction

The Client Protection Committee was formed following the MSBA 1991 Convention based on a recommendation of the Minnesota Supreme Court that a study be made of proposed permanent financing for the Client Security Fund. In establishing the Committee the MSBA Board of Governors authorized a broad scope of inquiry to include related issues such as:

- Consideration of methods to prevent defalcations from lawyer trust accounts;
- A study of the merits of having the Client Security Fund serve as an insurer of last resort for attorney malpractice;
- A review of the advisability of retaining a maximum limitation on payments made by the Client Security Board.

Committee members appointed by then-President Robert Monson represented a cross-section of the Bar, and involved the judiciary, state legislature, both large and small firm private practice, corporate counsel, and representation from the Client Security Board itself. The Committee members include the following:

Judge Terry Dempsey
Bert Greener
Mary Eichhorn-Hicks
Melvin Orenstein
Justice Peter Popovich
Allen Saeks
Donald Weinke

Merritt Marquardt, Chair
Mary Jo Ruff, MSBA Staff

The Committee has held 11 meetings and considered a wide range of issues relating to lawyer defalcation and client security. Resources available to the Committee included ABA reports and study findings, as well as published information of the Client Security Board in its operation as a function of the Minnesota Supreme Court. Interviews for background on the issues were conducted with the following:

Minnesota Client Security Board
Marcia Johnson, Director
Martin Cole, Assistant Director
William Wernz [former Director]

MSBA Consultant for Public Relations
Mary Schier

MSBA Public Law Section
Judge John Stanoch
Kim Mesun

Marsh & McLennan
John Navin, Sr. V.P.
Allen Stendahl, Sr. V.P.
Philip Purdy, Managing Director

Seabury and Smith [Insurance]
John Collentine, Program Manager

Minnesota Lawyers Mutual
Insurance Company
Joseph Bixler, CEO

* * *

II.

History of the Client Security Fund

The Client Security Fund was established by the MSBA in 1963 in response to a growing recognition by the Bar that certain issues of professional responsibility must be addressed by the professional organization of lawyers. In 1987 the administrative functions of the Fund were assumed by the Minnesota Supreme Court and the Client Security Board was formed to operate under the Court's jurisdiction. It has remained a part of Supreme Court operations since that time.

In an effort to establish a solid financial base and reserve for its operations, the Client Security Board in 1990 requested that the Court make a permanent $25 annual assessment to be imposed as part of the practice fee upon all licensed attorneys in the state. The MSBA responded with a counter-proposal for a one-time assessment of $50. The Supreme Court ordered an annual assessment of $20 for three years, and asked the Client Security Board and the MSBA to explore ways of permanently financing the Fund.

The Client Security Fund at present has approximately $1 million in reserves. During the past six years of operation the Board has paid 114 claims totaling over $1.5 million. The Board has published an Annual Report of its activities for each fiscal year of its existence. Its most recent report is attached as Exhibit "A." It is noted in the Report that in fiscal year 1992 claims declined in

dollar amount to $160,000 from the previous year's average of approximately $250,000. The cause of the decline is not certain, but the Board believes that vigorous and prompt disciplinary action may well be a factor.

The Board also maintains a policy of urging criminal prosecution against all lawyers who are found to have converted client trust funds. Claims are processed to completion in an average of 3-6 months unless the proceedings before the Lawyers Board of Professional Responsibility are delayed, or there is third party litigation pending. After five years of existence, the Board is conducting a review of its rules and expects to present its recommendations to the Supreme Court by the end of fiscal 1993.

In March of 1992, in response to a legislative request concerning claims denied by the Board, the Board prepared a table indicating the types of claims denied and the reasons therefor. A copy of that table is attached as Exhibit "B."

The Board also has prepared a table of reported client losses from July 1, 1987 through June 15, 1990, by area of law, as well as the awards or reimbursement by the Board for the same period of time. A copy is attached as Exhibit "C."

* * *

III.

Issues

In the preparation of this Report the Client Protection Committee reviewed the cause of what appears to be an increased incidence of lawyer theft throughout the country. Members of the Bar have speculated that the increased use of drugs and alcohol, combined with the intense pressures of modern practice, are a basis for the increase.

Members of the Client Security Board and its staff interviewed by the Committee were unable to provide any clear basis for these conclusions since there is no pattern which emerges from the five year experience of the Board. It appears that smaller claims, such as unearned retainer claims, generally are a result of lawyers having chemical dependency problems. However, the more substantial losses such as the Flanagan and Sampson cases usually go by default and there is no opportunity to develop the reasons which lead these lawyers to convert their clients' trust funds. A number of claims come about as a result of client investments with lawyers where the investments do poorly, and the lawyer in charge of the investment converts the available funds purely as a result of economic pressure.

The MSBA makes an annual contribution to "Lawyers Concerned for Lawyers." This private organization is concerned with chemically dependent lawyers. Approximately a year ago the MSBA filed a petition with the Supreme Court which would have authorized an assessment on lawyers for the purpose of establishing an assistance program addressing various emotional, financial, family and personal problems suffered by lawyers. That petition was denied.

A. Funding Sources

- Lawyer Assessments

The Client Security fund is currently maintained by an assessment of $100 on all newly admitted lawyers payable in two payments over four years as part of the annual registration fee and $20 per year upon all other lawyers licensed to practice in the state. The recent assessment was imposed by the Supreme Court in 1990 and remains effective through the 1992-93 fiscal year. At present the Fund reserve is slightly under $1 million.

A persuasive argument was made before the committee by Judge John Stanoch and Kim Mesun representing the MSBA Public Law Section that lawyers not engaged in private practice and generally employed by the public sector should be exempt from the assessment. However, the Committee believes that lawyer defalcation and the resultant injured client are a responsibility of the entire legal profession and that all licensed attorneys, regardless of the nature of their practice, should participate in the Court-mandated resolution of this problem. Indeed, the principle that "honest" lawyers must contribute to a fund to reimburse victims of "dishonest" lawyers is a concomitant of that belief. If the profession is willing to accept that principle it makes little sense to distinguish between in-house lawyers and public lawyers. Additionally, the administrative burden of keeping track of public lawyers who move into private practice and private lawyers who move into the public area presents an administrative burden for the Court. The Committee believes that the $20 per year assessment does not impose an undue financial burden on any lawyer, but regardless of that consideration, it considers the more compelling argument for an assessment to be the collective professional responsibility of all lawyers by reason of their unique role and status in maintaining the orderly governance of society.

As indicated in the 1990 Client Protection Fund Survey conducted by the ABA [Attachment"A"], eighteen state funds are capitalized by Supreme Court mandatory assessment. The ABA Study states, "This method of funding guarantees a reliable source of income to provide public information programs, adequate staffing, and, most importantly, the goal of full reimbursement. Mandatory assessment is evidence of the highest commitment to client protection" [§IV. p.iv].

The Committee also believes that lawyers newly admitted to the Bar should be assessed in the same manner as existing members of the Bar. At present the assessment schedule requires that new lawyers pay $50 their first year following admission, nothing in years two and three, and $50 again in the fourth year, after which they pay $20 each year. This arrangement was intended to represent an initial $100 assessment for new members and was designed to establish a parity with long-standing members of the Bar.

Members of the Client Security Board and their support staff strongly endorse the concept of a permanent assessment. Accordingly, the Committee recommends that a permanent annual assessment of $20 be established, subject to periodic review by the Court to ensure that the amount is adequate to both satisfy the historic level of claims while at the same time build a reasonable reserve for periods of extraordinary activity. Considerations which should enter into the Court's review include the Board's actual claims experience, the public's perception of a sufficient amount of money in the Fund to maintain the public's confidence in the protection provided by the legal profession, and the expedience with which the Court could respond to a set of major multiple claims which might conceivably otherwise drain the Fund of all its assets. A further consideration might properly be to what extent, as a policy matter, victims of lawyer theft should be compensated.

A reserve of $2.5 million is considered by the Committee to be a proper target and an amount which duly reflects the above considerations. It is based upon a factor of ten times the annual amount of claims generally experienced by the Board during its six-year history. The Committee also believes that

the MSBA and the Court should properly revisit the issue of the amount of reserve at such time as it has reached the recommended $2.5 million level.

· Bonding and Insurance

The Committee conducted an extensive review regarding the use of insurance and fidelity bonds as a means of providing financial resources for the Client Security Fund. Representatives of Marsh & McLennan presented various alternatives of coverage:

> · A Bar association indemnity bond operating on the principle of reinsurance by reimbursement of the Client Security Fund in the event of theft. Based on a per-occurrence concept, this instrument would contain an aggregate limit.
>
> · An excess bond covering the Fund for catastrophic circumstances should the entire reserve be depleted.
>
> · Fidelity coverage obtained by the individual lawyer through a committee or the MSBA, protecting the law firm and the client, with appropriate deductible limits.

The Committee also studied a proposal of Frank B. Hall & Company, a Boston insurance firm, which suggested mandatory bonding and reinsurance as a supplement to the existing mandatory assessment. Although the proposal included a 5% rebate for corollary malpractice insurance, the $200 annual premium was viewed as prohibitive regardless of whether the malpractice rebate feature was utilized by most lawyers.

In general, the Committee was not satisfied that either fidelity bonds or insurance represented viable cost-effective alternatives to the existing assessment program. The

comparative premium cost quotations for either bonding or insurance were simply not competitive with the $20 annual assessment as proposed, nor would such premiums provide the flexibility and the reserve-building capacity as discussed above.

Further, an insurance program tied to broad class-coverage requirements might impose qualification criteria which would make difficult if not impossible the goal of Bar-wide total client protection, particularly if funding were maintained through a consistent annual assessment. The Committee also noted that of the 46 states which maintain client security funds only the State of Montana has a fund from which claims are paid through the use of insurance proceeds. Since that state has relatively few lawyers, its experience in this area does not reflect the common experience of most other states. One other state has attempted to use insurance as a means of funding the client security fund, but after a year decided that the cost of insurance and the limited coverage available was simply not cost effective.

• IOLTA Funding

The use of funds for client security purposes from interest derived on Lawyer Trust Accounts was reviewed by the Committee. The IRS has consistently taken the position that a contribution to a Client Security Fund by an IOLTA Program would result in the loss of the tax-exempt status for the IOLTA Program. The IRS rationale is that the Client Security Fund promotes, protects and enhances the legal profession--not the public--and that therefore contributions to such Funds would reflect that the IOLTA Program was not being operated exclusively for tax-exempt purposes [see Kentucky Bar Foundation, Inc. v. Commissioner, 78T.C. 921(1982)].

In any event, the Committee recognizes that the original purpose of the IOLTA Program was to provide legal aid to the poor. Moreover, at a time when federal funding of legal services has been significantly reduced, and an overall reduction in interest rates paid by banks has also considerably reduced the funds available to legal services programs through IOLTA, the Committee believes that an additional burden ought not be placed on IOLTA to support Client Security.

B. Payment Issues

When the Client Security Fund was operated by the MSBA, payments were limited to $5,000 per claimant. The cap was increased to $50,000 per claim after the Supreme Court assumed responsibility for the Fund in 1987. Although several states have no stated cap on claims, Minnesota shares with Arizona, California, the District of Columbia, Hawaii, Iowa, Pennsylvania and Washington the cap of $50,000. New York at present has a stated claim maximum payment of $100,000.

Committee member Melvin Orenstein, who has served as Chair of the Client Security Board since it came under the Court's jurisdiction in 1987, has indicated that aside from numerous small unearned retainer claims, most claims fall within the $10,000 to $20,000 range. As assistant director of the Client Security Board, Martin Cole reported that on average there is one claim per year which exceeds the $50,000 cap. It is Cole's recommendation that the cap be raised to $100,000. The Committee believes that a Client Security Board rule allowing Board discretion in the payment of claims up to and even exceeding a "nominal" cap of $100,000 would be feasible. The Board should also be allowed discretion to at any time adjust the limitation cap downward based on factors enumerated in the Board's Rules.

The Committee also recommends payment of interest at the statutory rate on a discretionary basis from the date of filing the claim. Factors which should be considered by the Board in deciding to award interest would include the length of time between filing the claim and its disposition and whether delays, if any, were caused by disciplinary investigations, third party litigation, or other factors outside the control of the Board.

Fund reserves are at present invested through the office of the State Treasurer, with no apparent problems in the accounting of receipts and disbursements between that office and the Client Security Board. The Board is reported to be the only Minnesota state agency activity which is allowed to retain the interest earned on its monies placed with the Treasurer's office.

C. Client Security Board Operations

During the course of this study the Client Protection Committee obtained significant testimony regarding the Client Security Board, its operation and administration. Justice Popovich and Melvin Orenstein, as members of the Committee, provided first-hand information relating to creation of the Board and its functioning to date. The Committee also held interviews with the Board's professional staff; William Wernz, the former Director; Martin Cole, Assistant Director; and Marcia Johnson, the present Director.

Although the occasional and sensational media account of a claim before the Board might suggest a system in dysfunction, the Committee is in agreement that the Client Security Board has an outstanding record of providing client relief in the manner and under the guidelines envisioned by the Bar. The terms of several Board members are soon to expire, and the Board is using the occasion for a self-analysis with the expectation of making its own recommendations to the Court for such rule changes as may be appropriate.

Among the issues relating to Client Security Board governance and operations are the following:

· Composition of Board Membership

The Board presently consists of seven members appointed by the Court, two of whom are non-lawyers. Although some view a four to three ratio as more desirable, there was consensus among Board observers that the lay members were generally more conservative in granting claimant awards than were the lawyers. There appears to be no public concern over composition of Board membership, and the Committee believes the present structure is both workable and fair. It is noted that a similar state Board serving the medical profession contains no lay persons.

However, in the interest of broadening the base of representation of Bar membership on the Board, the Committee recommends the appointment of an attorney from the public service sector as one of the lawyer members. This recommendation is made in recognition of various concerns expressed by representatives of the MSBA Public Law Section in their meeting with the Committee.

· Judicial Review

In its discussion of Board operations, the Committee was reminded by the Messrs. Orenstein and Wernz that under the Board's rules as adopted and promulgated by the Court, reimbursement of a client's claim is a matter of Board discretion and not a right. Although this raises a question of public accountability, the Attorney General has argued before the Supreme Court in representing the Board on a claimant's appeal that the Court has no jurisdiction in these matters. If a rule change allowing judicial review is adopted, it will require significant additional resources for the Board to provide for maintaining a formal record of its proceedings.

The Committee recommends that mandatory judicial review of Board Actions not be made part of the Court's rule regarding Client Security Board operations.

· Board Rules and Policies

The Committee considered the question of whether interest should be paid on claims to the extent that their timely resolution is not obtained. According to Board records, once a decision has properly come before the Board, it is quickly rendered and a claim is awarded as required by the findings. Any delay is not a function of Board inaction, but rather a result of coordination with the procedures of the Lawyers' Professional Responsibility Board [LPRB], since that Board is also generally involved in lawyer defalcation problems. It is also noted that the Board engages in limited investigative work and generally relies for its fact-finding upon the LPRB and the courts. It is the consensus of the Committee that the Board functions well under its present policies and procedural rules, and that no major overhaul of its operations is required. A proposal that the Board adopt the Model Rules promulgated by the ABA is deemed unnecessary insofar as the substance of those rules is already contained in the current Minnesota Rules. A recommendation regarding the payment of interest is set forth in Section III.B above.

D. Prevention Issues

· Client Education

The Committee reviewed various proposals to better inform the public about the nature of the attorney-client relationship and how it is jeopardized by lawyer defalcation. The MSBA public relations consultant advised that in general the public is only concerned about making the concept of a client security fund work better than it does, and about whether the Bar is doing enough to prevent defalcation recurrence.

Favorable media coverage of compensation for lawyer defalcation is difficult to obtain in any event because the occurrence is always the negative fact of attorney theft. Even the proactive press coverage of Client Security Board operations stems from lawyer wrongdoing and is therefore difficult to utilize for purposes of favorable Bar publicity. The Committee also believes a broadly-based client education effort on the subject of attorney defalcation and how it might be avoided is difficult to accomplish and that the better course is for the Bar to be fully prepared for a response to the public as and when a story is sought by the media.

· Attorney Education

The basic requirements of a lawyer's ethical responsibility and faithful stewardship to the client must be a part of the law school applicant's character. However, the Bar can and should play a role in continually re-emphasizing these principles throughout the lawyer's professional career. Emphasis on professional integrity in CLE activities, such as "Bridging the Gap," must be a high priority in such programming. The Committee also believes the MSBA itself must continually stress compliance with the highest standards of professional integrity in all its publications and conferences.

· Random Audits

Although a program involving random audits of trust accounts would undoubtedly have some deterrent effect on lawyer defalcation, the Committee believes the administrative cost of maintaining such a program would not be justified. Defalcation occurs in both large firms and small, it involves the solo practitioner as well as corporate counsel.

Further, experience has shown that certain matters involving lawyer defalcation involve claims where a trust account was not involved, thus making the audit of trust accounts of little or no value in such occurrences. The general audit practice is to merely reconcile trust account balances, and such auditing techniques would of themselves also be inadequate to uncover defalcation. An audit which would deter any significant amount of trust account misconduct would have to be so broadly based as to make it cost prohibitive. In any event, the negative public reaction to just one substantial case of previously-undetected defalcation would only serve to place the entire audit effort into question. The Committee believes that available resources of time, energy and money can be better applied to existing Client Security Board operations and its Claimant Fund.

In an informal telephone discussion with the Executive Director of the Client Security Board in charge of random audits, the experience of the Iowa Board which established a random audit procedure in 1974 has indicated that the audit is nothing more than the above-described reconciliation of a lawyer's trust account and does not involve a full scale audit of a lawyer's records. The Board attempts to reach all attorneys over a four year period. For that purpose, it employs on an hourly basis three retired Internal Revenue agents who have audit experience. These individuals are used in other capacities by the Iowa disciplinary authorities and are also used to monitor the IOLTA accounts. The annual cost is approximately $40,000. Iowa has approximately 4,500 attorneys in private practice; Minnesota has more than three times that number in private practice, with the result that the cost would be substantially greater if that system were to be used in Minnesota.

· Double Signature and Insurance Company Notification

In several states client security is enhanced by a requirement that insurance settlement claim checks be made payable to and endorsed by both plaintiff and counsel. In New York, claim settlement payments in excess of a specified level require the insurance company's notification to the plaintiff client according to the information received from the administrator of the New York Client Security System. During the three year period since this notification requirement was imposed, New York has experienced a significant drop in client security claims of this type.

A similar rule applies in Pennsylvania on all claims over $1,000. The insurance industry was successful in defeating such a rule in North Carolina based on concerns over administrative costs and potential liability for failure to notify the client. The Committee believes that these preventive steps are reasonable, not unduly burdensome, and can serve to reduce the incidence of defalcation.

· Trust Overdraft Notification

The Minnesota Supreme Court recently adopted Rule 1.15(j) MRPC which requires banks to notify the office of the Director of Professional Responsibility of overdrafts in lawyer trust accounts. While it is too early to measure the effect of the Rule, the Director of Professional Responsibility has begun to contact lawyers where the size or incidence of overdrafts warrant question. The Committee believes that the establishment of procedures of this type will help lower the incidence of trust account theft.

* * *

IV.

Recommendations

Based on the determinations and findings outlined in this Report, the Client Protection Committee recommends to the MSBA Board of Governors:

1. That the Supreme Court adopt a uniform and on-going annual assessment of $20 upon all lawyers licensed to practice in the State of Minnesota for the purpose of providing revenue to the Client Security Fund. The assessment should be subject to a review of the annual assessment amount at such time as the Client Security Fund reserve account exceeds $2.5 million in order to determine whether such reserve is sufficient to provide for periods of extraordinary demand upon the Fund.

2. That the Supreme Court adopt rule changes to raise the payment cap to $100,000 per claim while still allowing the Board discretion to adjust that amount either upward or downward based on various factors as provided for in the Board Rules.

3. That the Supreme Court adopt a rule allowing for payment of interest at the statutory rate on a discretionary basis from the date of filing the claim. Factors to be considered by the Board in deciding to award interest would include the length of time between filing the claim and its disposition and investigations, third party litigation, or other factors outside the control of the Board.

4. That the Supreme Court Consider the appointment of an attorney from the public service sector as one of the lawyer members of the Client Security Board.

5. That mandatory judicial review of Board actions not be made part of the Court's rule regarding Client Security Board operations.

6. That the MSBA develop more effective educational and public relations programs for all lawyers and the general public regarding lawyer defalcation issues and the work of the Client Security Board.

7. That the MSBA widely disseminate to the general public information regarding the function and the availability of the Client Security Fund.

8. That the MSBA recommend a specific program to the law schools for office management including special emphasis on trust accounting.

9. That the Minnesota Department of Commerce enact insurance regulations which would require insurance companies licensed to do business in the State of Minnesota to notify claimants of insurance settlements made through the claimant's lawyer.

* * *

Respectfully submitted,

MSBA Client Protection Committee

cpro.ana