

AGENDA ITEM

54-113 MAY 9 2014

DATE: May 6, 2014

TO: Members, Board Committee on Operations
Members, Board of Trustees

FROM: Joseph Dunn, Executive Director/CEO

SUBJECT: Sponsorship of AB 1515 (Gonzalez): Duties and Advance Fees

EXECUTIVE SUMMARY

In the past several years, there has been a massive drain on the Client Security Fund as a direct result of reimbursements made to clients because of advance fees taken from clients but not earned by attorneys. AB 1515 would require an attorney to deposit fees and expenses that a client has paid in advance for legal services into a client trust account, to be withdrawn by the attorney only as services are provided and completed. AB 1515 would have a profound impact on the Client Security Fund, helping clients recover unearned fees directly from an attorney who has failed to perform the agreed upon work, rather than obtaining reimbursement from the Client Security Fund.

BACKGROUND

Pressure on the Client Security Fund

The State Bar administers the Client Security Fund (CSF), which reimburses clients who have lost money or property due to theft or other dishonest acts committed by attorneys. The CSF is funded by all attorneys, who pay a set amount for the CSF as part of their annual dues bill. In the past several years, there has been a massive drain on the CSF as a direct result of reimbursements made to clients because of advance fees taken from clients but not earned by attorneys.

In 2011, 2012 and 2013, the majority of CSF reimbursements have been in the unearned advance fee category. Specifically:

- In 2011 CSF paid out a total of \$7.8 million on 1,534 applications. Of the 1,534 applications paid, 76.7% were unearned advance fee cases. This represented 61.9% of the \$7.8 million paid.

- In 2012, CSF paid out a total of \$6.8 million on 1,466 applications. Of the 1,466 applications paid, 95% were unearned fee cases. This represented 70.8% of the \$6.8 million paid.
- In 2013, CSF paid out a total of \$11 million on 1,999 applications. Of the 1,999 applications paid, 93.5% were unearned fee cases. This represented 77.2% of the \$11 million paid.

By requiring attorneys to deposit advance fees into a client trust account until the agreed upon services have been provided and completed, AB 1515 would have a profound impact on the Client Security Fund. If attorneys are required to place advance fees in their client trust accounts until those fees have been earned, the trust account records would assist in helping clients establish and recover the amounts received by the attorney in the event the attorney fails to perform the agreed upon work.

Existing Rule of Professional Conduct

Existing Rule 4-100(A) of the Rules of Professional Conduct provides, in part: “All funds received or held for the benefit of clients by a member or law firm, including advances for costs and expenses, shall be deposited in one or more identifiable bank accounts labeled ‘Trust Account,’ ‘Client’s Funds Account’ or words of similar import, maintained in the State of California, or, with written consent of the client, in any other jurisdiction where there is a substantial relationship between the client or the client’s business and the other jurisdiction.”

In *Baranowski v. State Bar* (1979) 24 Cal.3d 153, 163 the California Supreme Court found that the predecessor to Rule 4-100 (former Rule 8-101, with the same language as current Rule 4-100 to the extent relevant here) expressly requires that sums advanced to pay costs or expenses be placed in a separate trust account but does not expressly deal with advance legal fees.

Changes that AB 1515 would make

AB 1515 would explicitly impose a duty to deposit into a client trust account fees, costs, and expenses that a client has paid in advance for legal services, to be withdrawn by the attorney only as services are provided and completed. Creation and maintenance of a client trust account is rooted in the general principle that an attorney who holds the funds or property of a client or third person in trust, even if for a brief time or intermittently, has an obligation to safeguard and segregate those assets from the attorney’s personal and business assets. Client and third party funds are properly protected by a requirement to segregate and account for them in a client trust account. It should not make any difference whether those client funds are characterized as a cost, an expense, or an advance legal fee.

The language in the current version of AB 1515 is taken from ABA Model Rule of Professional Conduct, Rule 1.15(c). At least 30 other states have adopted ABA Model

Rule 1.15(c) or an equivalent policy, requiring an attorney to deposit and hold legal fees paid in advance in a client trust account and not withdraw them until they are earned. Proposed additional language would provide that any fee paid in advance as the set amount of the fee for specified legal services (whether paid as a “fixed” fee, a “flat” fee, or under any other label) is “earned” only when the attorney has performed and completed the legal services agreed to be provided in exchange for that fee, but allow that fee to be withdrawn in stages, provided the agreement with the client specifies each stage and sets the amount of the advance fee for each stage. We would continue to work with Assembly Member Gonzalez and the interested stakeholders in an effort to address issues that have been raised.

ISSUE

Whether the State Bar of California should be the sponsor of Assembly Bill 1515 to clarify that fees and expenses that a client has paid in advance for legal services should be required to be held in a client trust account and withdrawn only as services are provided and completed.

CONCLUSION

AB 1515 would alleviate pressure on the Client Security, which has recently experienced a massive drain as a direct result of reimbursements made to clients because of advance fees taken from clients but not earned by attorneys. This will serve to further public protection and public confidence in the legal profession.

DISCUSSION

Sponsorship of a piece of legislation means that the sponsoring entity is considered the source of the proposal and the primary stakeholder.

FISCAL / PERSONNEL IMPACT:

None.

RULE AMENDMENTS:

None.

BOARD BOOK IMPACT:

None.

RECOMMENDATION

Because AB 1515 would enhance the State Bar’s mission of public protection, the Board should adopt the recommendation to sponsor AB 1515.

PROPOSED BOARD COMMITTEE RESOLUTION:

Should the Board Committee on Operations agree with the above recommendation, the following resolution would be appropriate:

RESOLVED, that the Board Committee on Operations recommends that the Board sponsor Assembly Bill 1515, **with the understanding that the following elements are contained in the bill:**

- **Adds duty for attorney to deposit into client trust account advance fees for legal services and to withdraw only when earned**
- **Includes “fixed” or “flat” fees**
- **Permits fixed or flat fees to be earned and withdrawn in stages if agreement specifies the stage and amounts**
- **Permits exemption for advance fees in criminal and bankruptcy cases, where services involve representation in court**
- **Permits the Board to add an exemption**

And that staff and legislative advocates continue to work with all interested parties to resolve concerns.

PROPOSED BOARD OF TRUSTEES RESOLUTION:

Should the Board concur with the Board Committee on Operations’s recommendation, the following resolutions would be in order:

RESOLVED, that upon the recommendation of the Board Committee on Operations, the Board hereby agrees to be the sponsor of Assembly Bill 1515, with the understanding that the following elements are contained in the bill:

- Adds duty for attorney to deposit into client trust account advance fees for legal services and to withdraw only when earned
- Includes “fixed” or “flat” fees
- Permits fixed or flat fees to be earned and withdrawn in stages if agreement specifies the stage and amounts
- Permits exemption for advance fees in criminal and bankruptcy cases, where services involve representation in court
- Permits the Board to add an exemption

And that staff and legislative advocates continue to work with all interested parties to resolve concerns.