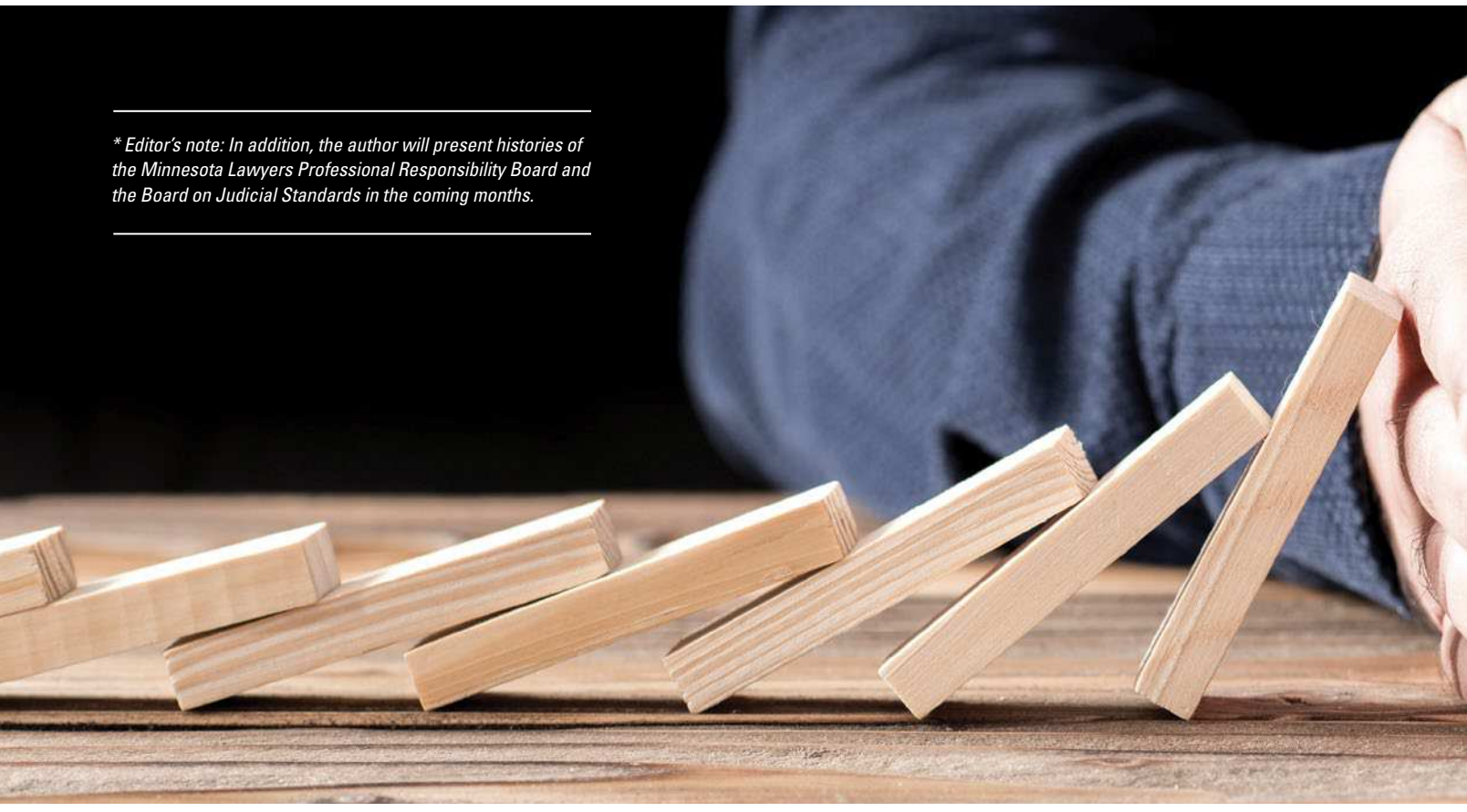
OUT, DAMNED SPOT!

THE CREATION OF THE CLIENT SECURITY BOARD: A DRAMA IN THREE ACTS

The Minnesota Client Security Board, born in the 1980s amid the crisis stemming from two lawyers' high-profile theft of client funds, has been reimbursing the victims of financial crimes by attorneys for over 30 years. In this short history—the first in a series—the author, the first CSB director and also director of the Office of Lawyers Professional Responsibility at the time, recalls the circumstances of the CSB's creation and its subsequent evolution.*

BY WILLIAM J. WERNZ



** Editor's note: In addition, the author will present histories of the Minnesota Lawyers Professional Responsibility Board and the Board on Judicial Standards in the coming months.*

Act I of the dramatic early history of the Minnesota Client Security Board (CSB) starred St. Paul attorney John J. Flanagan as the tale's first villain. In early July 1985, he absconded with client funds eventually calculated at about $450,000. This was big news, and the media came calling to ask what would be done. For me, it was a baptism by fire, as I had just been appointed acting director of the Office of Lawyers Professional Responsibility (OLPR) on July 1, 1985.

Flanagan's license to practice law was quickly suspended. A trusteeship was established to handle his law files. A few months later, the FBI found Flanagan hiding in Utah. He was charged, convicted, and incarcerated. He was also disbarred. So far, so good.

Review of Flanagan's client files showed that he had been stealing client funds for many years. His M.O. was to forge personal injury settlement checks, lie to clients about their cases, and take the money for his own use. What could be done to help the victimized clients?

Eventually, many clients found remedies against banks, because the banks had paid on Flanagan's forged signatures. As for the others, "not much" was the unsatisfactory answer. There was the MSBA Client Security Fund, established in 1963—a noble but inadequate effort. The fund received money through bar allocations and voluntary contributions, and it capped payments at $5,000 per victim. Bar and judicial leaders agreed that something had to be done for the victims, but what?

One option, proposed by a lawyer and state senator named Ron Sieloff, was that the Legislature require every Minnesota lawyer to obtain a fidelity bond. But the underwriting expenses would be huge and some lawyers, if rejected by bonding companies, might not be able to practice law. In addition, legislative regulation of lawyers was problematic: The Minnesota Supreme Court asserted the exclusive authority of the judiciary to regulate the legal profession.

The ABA provided a different option, already adopted in Iowa, Wisconsin, and some other states. In 1981, the ABA had drafted Model Rules for Client Security Funds. In voluntary bar states (like Minnesota), the fund would be operated by a board appointed by the state Supreme Court. In other states, the mandatory bar association would operate the fund.

Act II of the CSB drama began when Minnesota Supreme Court Chief Justice Douglas Amdahl called Ron Sieloff and asked him to join a group of leaders from the MSBA and Lawyers Board to discuss the client security fund option. From the vantage point of my 36 years of work in the Minnesota professional responsibility system, I would call Justice Amdahl's approach admirable and typical. The bench and bar have worked collaboratively with all interested parties in addressing the profession's issues and problems.

Creating the CSB

The client security fund option was promptly chosen. In November 1985, the MSBA filed a petition in the Minnesota Supreme Court requesting appointment of a Client Security Board. The petition also requested transfer of approximately $145,000 in MSBA security funds to the new CSB fund. Plan A was for this transfer to be supplemented by an annual registration fee of $20, paid by attorneys until the fund had a stable balance of $1,000,000. Caps could be set, limiting compensation to individual victims.

After the petition was filed, then-MSBA President Leonard Keyes wrote a column, "On Client Reparations," explaining why the Client Security Board was the best option.[1] In March 1986, after a notice and comment period, the Minnesota Supreme Court held a public hearing on the MSBA petition. By order of April 15, 1986, the Court approved the petition and appointed the first Board, comprising five lawyers and two public members. Attorney members included the first chair, Mel Orenstein, and Ron Sieloff. Orenstein had chaired the MSBA Client Security Fund and had been greatly involved in proposing creation of the CSB. I was appointed the first CSB director, to provide administrative and other services. The Court's order directed the new board to draft rules for operation and submit them to the Court for adoption, but otherwise not to begin operations.

Mel Orenstein, a Lindquist & Vennum partner, was chair of both the MSBA fund and the Client Security Board. Now 93 years old, Orenstein recalls the Board's origins as a "very eventful" time. He knew he had to do a great sales job at the MSBA convention, because if the MSBA rank and file objected, the board's future would be shaky. After Mel's pitch, one prominent lawyer stood up and announced, "I'm all for it." A lot of hard work remained, but success appeared all but certain.

Déjà vu all over again

Act III noisily usurped the stage before Act II had finished. In October 1986, as the new board was drafting rules, Fridley attorney Mark Sampson absconded, with over $400,000 in client funds missing. As with Flanagan, there was a great deal of publicity, a trusteeship was created, and Sampson was disbarred *in absentia.* It became apparent that the funding proposal of $20 annually per attorney would not suffice to pay the Flanagan and Sampson victims promptly, let alone to create an ongoing healthy fund balance. As with Flanagan, the media was intensely interested in how victims would be treated. In 1992, Sampson was found, in Taos, New Mexico, where he was awaiting incarceration on a bad check conviction. His sentence included a long prison term and a restitution order.

Sampson disappeared just before he was to be publicly disciplined for misconduct unrelated to theft—primarily neglect of client files and poor communication. A suspension was recommended, but no one had alleged financial improprieties. Nonetheless, OLPR asked Sampson for a small sample of his trust account books and records. Sampson produced documents that included original bank statements—some of them, it turned out, fabricated. Sampson had managed to steal genuine original bank statement paper and use the bank's printer after hours, producing for OLPR a mixture of genuine documents and perfect forgeries. After Sampson fled, the FBI found in his office work papers for coordinating real and fake bank documents, so as to deceive us. If misappropriation had been more strongly and specifically suspected, OLPR would have obtained bank records by subpoena. No other attorney I've encountered was as artful at deception as Sampson. Why didn't he put that kind of resourcefulness to honest uses? That question has been asked many times.

In late 1986, the CSB filed a petition asking the Court to approve its operational rules and its funding. By order dated April 7, 1987, the Court approved the rules, effective July 1, 1987. The order provided that each Minnesota lawyer would pay a one-time fee of $100 to fund the CSB. On August 6, 1987, the board held its first operational meeting, approving payment of three claims. In a short time, the board paid $404,742 to Sampson's victims and $113,627 to Flanagan's victims.

Some lawyers grumbled about the $100 fee. One sued in federal court to block it, but the suit was dismissed. Over time, the controversy ebbed, then disappeared. In 1991, the Court revised the funding to allocate a portion of the annual registration fee to the board's operation. That system remains in effect.

The board's initial rules included a limit of $50,000 payment per client-victim. There was no limit on payments per dishonest lawyer. Payment could be made only for losses caused to clients by a lawyer's dishonest conduct in an attorney-client relationship or in a fiduciary relationship arising from an attorney-client relationship. Loss from mere malpractice was not covered. Payments were not made insofar as other sources of compensation were available. When James O'Hagan (disbarred 1990), David Moskal (1998), and Michael Margulies (2010) stole client money, restitution was made by their large law firms or other parties, and the board did not make payments.

In Minnesota the OLPR director is also the CSB director. The ABA recommends separate directors, out of concern that a single director of two boards could face conflicting duties. Minnesota has not experienced such problems, and Minnesota's administrative expenses are about half the national average.

Board Rule 3.01 provides, "Reimbursements of losses by the Board are discretionary, and not a matter of right. No person shall have a right in the Fund as a third party beneficiary or otherwise either before or after allowance of a claim." However, the board seeks consistency in paying claims, rather than relying on its right to act out of discretion.

The $50,000 per victim cap remained in place until 1993, when the Supreme Court held a hearing on whether to raise the cap on payment from $50,000 to $100,000. Two lawyers, Bruce Wyant and Dennis Morgeson, had induced a group of elderly clients to invest over $1.5 million dollars in a business, but most of the funds were taken without being invested. The referee in Wyant's disbarment cases summed up matters well: "At some point Wyant & Morgeson ceased operating as a law firm seeking to provide legal services to its clients and became a mining operation seeking to extract capital from its clients' assets."

At the hearing, some of the elderly clients described their losses, exceeding $50,000 or even $100,000. The MSBA did not take a position on the issue, but MSBA President Roger Stageberg stated at the hearing that he, personally, endorsed the $100,000 cap. The increase was granted and the board paid victims of Wyant and Morgeson $547,900. (I represented several investors/victims.)

Then and now

The drama of the CSB's early days has been followed by three decades of steady, solid work and service. The 2017 CSB Annual Report and a recent article by the current CSB director, Susan Humiston, describe the board's current operations and conditions.[2] One fact helps capture the magnitude of the board's work: In its 30-year history, the board has paid out $8,173,277. The average annual payout by the Board has been over $250,000. In 2016-17 payouts totaled $747,094—about two thirds of which was paid to victims of Mark David Holt—but in 2015-16 payouts totaled only $53,516. A list of all claims paid and all attorneys responsible for the payouts is on the board's website. For most attorneys, $12 of the annual registration fee is allocated to the board.

In 2016, the fund's balance exceeded $4 million and in 2017 approximately $3.6 million was on hand. In 1998, the Court had recommended that the board notify the Court if the fund's balance was projected to fall below $1.5 million or rise above $2.5 million. Accordingly, the 2017 Annual Report states that "the Court has decided to redirect a portion of the CSB assessment to other regulatory boards."[3] When the fund exceeds targeted balances, the Court also has the option of suspending payment of the board's portion of the registration fee, as it did in 2008-09.

Although the board has not received a great deal of attention in the media, one 2014 article reported very favorably on its work.[4] The article included an interview with a single mother whose lawyer's dishonesty caused a "five-figure" loss paid by the board. The claimant called the board "a blessing for what they do" and said the board's staff "under-promised and over-delivered…. they were just super helpful."

Lessons learned

Let me bring the curtain down with several reflections on this drama. In recent decades many articles have been critical of the legal profession. These critiques almost always ignore what might be called the social ethics of the profession. To what degree do the state's lawyers provide pro bono services? Are public defenders properly appointed and funded? Are ethics complaints handled promptly and fairly? Does the profession protect the public from really bad apples? In a more targeted critique, a series of *National Law Journal* articles gave a very negative rating to many states' client security arrangements.[5] The articles reported, "[Client protection funds] are poorly endowed, stingy about payouts and virtually a secret, even to many lawyers whose bar dues help finance them."

Minnesota compares very favorably with other states with respect both to the general questions above and to the specific NLJ critique of client security funds. Since 2001 Minnesota's cap on payment to any one victim has been $150,000. This cap is one of the highest in the country and many states—such as South Dakota ($10,000) and Louisiana ($25,000)—have much lower caps. Unlike Minnesota, some other states limit aggregate payments to victims of any one dishonest lawyer—Iowa, for example, has a $300,000 aggregate limit. It should be a point of pride among Minnesota lawyers that we stand behind lawyers to this degree.

My first column as OLPR director was titled, "On Doing the Job Ourselves."[6] I borrowed from the first OLPR director, Richie Reavill, whose first column explained, "We felt we owed the public the obligation to do the job ourselves." Reavill was writing about the creation of the Lawyers Board and OLPR in 1970, but his words about the discipline system would become equally applicable to the client security system.

Now, three decades after the CSB's creation, I believe we can confidently and proudly say, "Jobs well done, and by lawyers themselves" (without forgetting the contribution of the board's public members). Read the CSB annual reports on the CSB website and you will see the often demanding and gritty work of determining whether a lawyer was dishonest, in what amount losses may have occurred, and whether losses were cause by dishonesty in the lawyer's legal or fiduciary capacity.

Although there was some grumbling when the initial $100 per lawyer assessment was levied, lawyers have become accustomed to the payments. They should also know of the splendid work done to recover funds from miscreant lawyers and from alternate sources. The Attorney General provides legal services for these efforts. Minnesota lawyers will no doubt have their hearts warmed by learning that Mark Sampson himself has paid $141,194 in restitution, inspired no doubt by his criminal sentencing order. It's often said that there aren't happy endings anymore, but this will do! ▲

Notes

[1] Leonard J. Keyes, "President's Page – On Client Reparations," Bench & Bar of Minnesota, Jan. 1986.
[2] Susan M. Humiston, "Helping Victims of Lawyer Dishonesty," Bench & Bar of Minnesota, May/June 2017.
[3] 2017 Annual Report of the Minnesota Client Security Board at 3. *http://csb.mncourts.gov/Pages/2017%20CSB%20Annual%20Report.pdf*
[4] David Chanen, "Little-Known Minnesota Board Compensates Victims of Wayward Lawyers," StarTribune 1/31/2014.
[5] The articles were titled, "An Empty Promise: How client protection funds betray those they were designed to protect." The NLJ articles are described in Martin A. Cole, "Client Security: Can We Do Even More?" Bench & Bar of Minnesota, July 2001.
[6] William J. Wernz, "On Doing the Job Ourselves," Bench & Bar of Minnesota, Nov. 1985.

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