by W. David Harless

Client Protection: Payee Notification and Clients' Protection Fund

In 2011, my predecessor, George Warren Shanks, appointed the Payee Notification Task Force. It consisted of eighteen members reflecting past and present leadership of the Virginia State Bar, Virginia Bar Association, Virginia Trial Lawyers Association, Virginia Association of Defense Attorneys, Virginia Women Attorneys Association, and individuals with legislative experience and experience in the insurance industry. Its mission was to tackle the thorny issue of payee notification legislation.

Since 2006, the debate regarding payee notification has been contentious. In council meetings, advocates have championed this protection as the surest safeguard against lawyer theft of client settlement payments. Opponents have countered by arguing that the measure unfairly singled out personal injury practitioners regarding a risk that is present in any settlement context. More importantly, opponents decried the authorization of an insurance company's direct communications with a represented plaintiff.

Over time, ardent opponents, like me, became reserved supporters of the measure. In 2007, council overwhelmingly defeated a payee notification measure. In 2009, however, confronted by the sobering news of the multimillion dollar defalcation by attorney Stephen Conrad, council approved it in a close vote and moved forward with payee notification legislation. On a separate track, the VTLA embraced the need for payee notification protection, but offered competing legislation that broadened its scope to encompass payments by insurers in all liability matters, not simply personal injury cases.

At the behest of then Chief Justice Leroy R. Hassell Sr., the VSB and the VTLA withdrew its proposed legislation and awaited further instruction from the Court. At the Court's direction, the task force was created to reconcile the differences between the competing payee notification measures sponsored by the VSB and the VTLA, and to provide such further recommendations as deemed appropriate. To that end, the task force has recently submitted a report to the Supreme Court providing its unanimous recommendations.

In response to its primary charge, the task force has recommended that insurance companies be required to notify claimants or judgment creditors that the insurer has issued a payment of $5,000 or more in settlement of a liability claim or judgment to the attorney or other representative of the claimant or judgment creditor. Council will address and vote upon this recommendation at its October 19, 2012, meeting. If approved, the proposed statute will be returned to the Supreme Court for consideration, with the hope of presenting this matter to the Virginia General Assembly for consideration in January 2013.

As mentioned above, payee notification has received considerable comment during the past six years that due to space limitations cannot be repeated in this column. However, the proposed statute can be accessed for your review at the VSB's website at http://www.vsb.org/site/news/item/payee-notification-2012-06. The bar welcomes your comments.

The task force did not limit its consideration to payee notification alone. Embracing a multi-faceted approach to the public protection of clients against lawyer defalcations, the task force made recommendations regarding the Clients' Protection Fund (CPF). The CPF was established in 1997 to compensate persons who have suffered financial loss caused by the dishonest conduct of a Virginia lawyer. Currently, the loss to be paid to any one client petitioner cannot exceed $50,000. Reimbursement of losses attributable to any one lawyer or law firm is limited to 10 percent of the CPF's net worth.

The task force has recommended that the per claim maximum for the CPF be increased from $50,000 to $100,000 per client, and that the maximum payments for each defalcating attorney be increased from 10 percent to 15 percent of the net worth of the CPF. Additionally, the task force has recommended that the CPF undertake an actuarial study of the fiscal effect of its recommendation.

An actuarial study of the CPF by the bar would not be its first. In a 2005 study, actuaries determined that the CPF needed a corpus of approximately $9 million to provide earnings from interest sufficient to satisfy projected future claims against the CPF. In

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response, the General Assembly and the Supreme Court approved a $25 per year CPF assessment for each active member of the bar. The assessment became effective in 2007, but has a "sunset" provision making it effective only through June 30, 2015. While the mandatory CPF assessment has increased and will continue to increase the net worth of the CPF fund until June 30, 2015, the CPF nonetheless will not achieve the $9 million benchmark or the desired future claims payment capability under present circumstances.

Over the remaining three-year life of the statutory assessment, the CPF should receive an average of $750,000 annually. Claims payments since July 1, 2004, have averaged approximately $337,600 annually. If this claims experience holds constant, the CPF will increase its net worth by approximately $1,200,000 over the next three years. As of June 30, 2012, the net worth of the CPF was just over $5,800,000. Based on these assumptions, the net worth of the CPF will total approximately $7 million as of June 30, 2015, approximately $2 million short of the $9 million recommended by the 2005 actuarial study.

Additionally, since FY2004, the average yield on CPF investments has been 3.8 percent, nominally higher than the 3.5 percent return assumed in the 2005 actuarial study. However, the rules governing the CPF require that all funds be invested in certificates of deposit, U.S. governmental securities, and federal agency securities. The recent yield for these investments has been significantly lower than the 3.5 percent investment yield that formed the basis for the 2005 actuarial projections. For example, the interest income in FY2012, net of bank service charges, totaled $192,428. Unfortunately, we may reasonably expect that these investment conditions will continue for the indefinite future.

The recommendations of the task force are timely and consistent with the VSB's client protection mission. The members of the task force deserve our unqualified gratitude for their service and their unanimous commitment to achieving consensus regarding these issues. These recommendations require our profession's immediate attention. I commend them to your thoughtful consideration and comment.