

# PROPOSED PAYEE NOTIFICATION LEGISLATION

## Issue

Should the State Bar of Michigan advocate for state legislation that would implement payee notification when a claim is paid with insurance funds?

RESOLVED, as an additional client protection measure, that the State Bar of Michigan supports proposing state legislation to enact payee notification when a claim is paid with insurance funds.

## Synopsis

Payee notification is an effective client protection measure that has been implemented in 15 other states to prevent attorney misappropriation of settlement funds. After its implementation, all 15 states reported a decline in attorney misappropriation of settlement funds.

Legislation implementing payee notification would require that the insurer issue notification to the client and attorney of record when the insurer remits settlement proceeds to resolve a liability claim. Payee notification serves both the preventive and maintenance purposes of a client protection program by improving transparency and accountability.

Payee notification may have prevented millions of dollars in losses resulting from the unfortunate instances of a few Michigan attorneys who misappropriated settlement proceeds from their clients. Typically, when settling a liability claim, an insurer issues a settlement payable to the client and the client's attorney and remits the payment to the client's attorney without any notification to the client. Unethical attorneys have misappropriated client settlement proceeds without the client discovering the conversion for months. Payee notification gives notice to clients that the settlement payment has been issued to their attorney, which may prompt the client to contact their attorney to confirm the timing for receipt of the funds if the attorney has not already provided such information. This simple and efficient notification system has been shown to be an effective deterrent to misappropriation of client funds by their attorneys.

Payee notification helps foster greater client trust in the legal profession, minimize the likelihood that a dishonest attorney will settle a claim without the knowledge and consent of the client, reduce the potential that a dishonest attorney will fraudulently endorse a settlement check and misappropriate the funds, and enable more timely discovery of dishonest attorney conduct should it occur.

## Background

### **1. Problem: A Few Dishonest Attorneys Misappropriating Millions of Dollars of Client Settlement Funds**

In the past decade, Michigan clients have suffered losses totaling millions of dollars due to theft by their attorneys. These thefts often occur when an insurance company remits a settlement check to the attorney and then the attorney misappropriates the funds. Once the funds are misappropriated, victims of attorney theft have limited avenues for recovery, as the attorney rarely has the funds or assets

available to repay the client. If the attorney forged the client's signature on a check, the client may recover from the bank or the client may receive funds from a malpractice insurer or bonding company. The client may obtain a civil judgment or be included in a criminal restitution order, but recovery requires that the attorney have funds or assets with which to compensate the client.

As a last resort, clients can turn to the State Bar of Michigan's Client Protection Fund (Fund). The Fund was created to reimburse clients for losses incurred due to the dishonest conduct of their attorneys and is financed by an annual assessment from each licensed attorney in the State of Michigan. Due to the Fund's limited resources, reimbursement is capped at \$150,000 per claimant and \$375,000 per attorney.<sup>1</sup> Often, the Fund is unable to fully reimburse clients for their losses. For example, CPF processed over \$1.5 million in claims pending against one attorney who advised his clients he had not received settlement proceeds from the insurance companies and then misappropriated the funds. The Fund only reimbursed a total of \$375,000, which was prorated amongst the claimants.

Over the last five years, while the number of claims has remained consistent, the Fund has experienced a notable increase in the monetary value of the claims. Without increasing the Fund payment caps, which would require an increase in SBM members' annual Fund assessment,<sup>2</sup> victims of attorney theft are forced to shoulder higher unreimbursed losses.

As the fiduciary for the Fund, the State Bar of Michigan (SBM) is responsible for advocating and implementing "studies and programs for client protection and prevention of dishonest conduct by attorneys."<sup>3</sup> To further address the problem of dishonest conduct by attorneys, the Payee Notification Workgroup composed of members of the CFP Committee, the Attorney Discipline Board, the Attorney Grievance Commission, and other interested attorneys was formed at the request of the Board of Commissioners' Professional Standards Committee.<sup>4</sup> Based upon study of this issue, the CPF Committee and the Payee Notification Workgroup recommend that SBM support proposing legislation to enact payee notification in Michigan. After reviewing the report and recommendation of the Payee Notification Workgroup, the Board of Commissioners supported implementation of payee notification in Michigan.

## **2. A Payee Notification System Has the Potential to Significantly Address this Problem.**

Payee notification was first enacted in New York in 1988.<sup>5</sup> Since then, 14 other states have adopted payee notification.<sup>6</sup> After enacting payee notification, each jurisdiction experienced a decline in the number of claims attributable to attorney theft of settlement proceeds.

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<sup>1</sup> [Client Protection Fund \(CPF\) Rule 12\(B\) & \(C\)](#).

<sup>2</sup> The Fund receives its funding from attorneys as part of their [annual dues](#). Currently all active members are assessed \$15, with inactive members being assessed \$7.50.

<sup>3</sup> [CPF Rule 7A\(7\)](#).

<sup>4</sup> The [SBM Standing Committee on Client Protection](#), with support from the Board of Commissioners Professional Standards Committee, created a workgroup to review and make recommendations regarding implementation of a payee notification program. See Attachment 1.

<sup>5</sup> [11 NYCRR 216.9 \(A\) & \(B\)](#).

<sup>6</sup> Nine states have implemented statutes: [California](#), [Connecticut](#), [Georgia](#), [Maryland](#), [Nevada](#), [New York](#), [Pennsylvania](#), [Rhode Island](#), and [Virginia](#). Five have enacted insurance or business regulations or administrative codes requiring notification: [Delaware](#), [Hawaii](#), [Massachusetts](#), [Nebraska](#), [New Jersey](#) and [Texas](#). A statute requiring payee notification would apply to a broader array of insurable losses, increasing the effectiveness of the program.

In Michigan since 2003, payee notification might have prevented as much as \$3,061,632.39 in client losses based on approved Fund claims involving attorney theft.<sup>7</sup> Due to reimbursement caps, the Fund paid only \$1,216,620.18 of these claims, resulting in clients suffering \$1,845,012.21 in unrecovered losses. The potential positive impact of a payee notification program is likely far greater, as these numbers only include clients that requested reimbursement from the Fund and not those reimbursed by other sources such as banks for accepting fraudulent endorsements, malpractice insurance carriers, or bonding agencies.

Not only will a payee notification program help clients, but it will also assist SBM in fulfilling its fiduciary duties to the Fund without increasing its assessment on SBM members. The American Bar Association Standing Committee on Client Protection (ABA Committee), the National Client Protection Organization, and the Conference of Chief Justices endorse as a goal of every client protection fund to fully reimburse claimants.<sup>8</sup> To currently achieve this goal in Michigan, the annual Fund assessment for active members of \$15 would need to be increased to \$64.49 and the annual Fund assessment for inactive members of \$7.50 would need to be increased to \$32.24.<sup>9</sup> While the Fund currently falls far short of meeting the goal of full reimbursement of all claims, payee notification has the potential to improve the health of the Fund by preventing harm to clients who would otherwise be Fund claimants and thereby ensuring the availability to more Funds for payment of claims without increasing Fund assessments for SBM members.

Payee notification was recommended by the SBM's 21<sup>st</sup> Century Practice Task Force.<sup>10</sup> It has also been recommend by the American Bar Association Center for Professional Responsibility. Moreover, Goal 3 of the SBM 2017-2020 Strategic Plan includes development and adoption of a payee notification program in Michigan to support the goal of maintaining “the highest conduct among its members.”<sup>11</sup>

The CPF Committee and the Payee Notification Workgroup recommend that legislation implementing payee notification include these key components:

- A minimum payment amount to trigger the payee notification requirement. In most states, the minimum is \$5,000.

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<sup>7</sup> See Attachment 3.

<sup>8</sup> The ABA Committee recommends payee notification, along with five other client protection programs: [Trust Account Overdraft Notification](#) (TAON), [Random Audit of Trust Accounts](#), [Payee Notification](#), [Disclosure of Insurance](#), [Fee Arbitration](#), and [Mediation of Non-Fee Disputes](#). To date, Michigan has adopted three of these programs – TAON, mandatory disclosure of malpractice insurance to SBM, and fee arbitration through the Attorney Grievance Commission. Other states, including Hawaii and Delaware, have adopted all six programs and experienced a reduction in claims, including years in which there were no claims filed with the Client Protection Fund.

<sup>9</sup> See Attachment 2.

<sup>10</sup> The [Task Force Report](#) recommended payee notification to support the implementation of “proactive or preventative measures that help attorneys avoid ethical missteps and serve a consumer protection function . . .” Mark A. Armitage, Task Force; Regulatory Committee.

<sup>11</sup> [SBM Strategic Plan 2017-2020](#), Adopted by the Board of Commissioners January 20, 2017, and approved by the Representative Assembly on April 22, 2017.

- A provision ensuring that the method of notification is reasonably calculated to be received by the payee and the payee’s attorneys, considering electronic communication.
- A method to help ensure that the insurer has current contact information for the payee.
- A requirement that the notification includes provisions from the payee notification statute and the Michigan Rules of Professional Conduct regarding an attorney’s duty to promptly deliver funds to a client or third party.

**Board of Commissioners’ Action**

The Board of Commissioners Professional Standards Committee requested the Client Protection Fund Committee study payee notification as a way to reduce misappropriation of client funds by their attorneys. SBM’s 21<sup>st</sup> Century Practice Task Force<sup>12</sup> and the 2017-2020 Strategic Plan both endorse implementation of payee notification to bolster SBM’s client protection measures.<sup>13</sup> During the Board of Commissioners’ (BOC) [July 21, 2017 Meeting](#), it requested that the Payee Notification Workgroup reach out to relevant SBM sections to obtain the reaction to payee notification. The Negligence Law Section Council supports implementation of payee notification in Michigan.<sup>14</sup> There has also been outreach to the Insurance & Indemnity Law and the Probate and Estate Planning Sections and neither has expressed opposition.

During the BOC’s January 26, 2018 meeting, a motion was offered and supported to authorize SBM to advocate for Payee notification legislation with the elements listed in the memo of the work group recommendations provided in the Board materials, and to also refer this proposal to the RA for their consideration.

**Opposition**

None known.

**Prior Action by Representative Assembly**

None in the recorded records.

**Fiscal and Staffing Impact on the State Bar of Michigan**

Existing staff resources will be allocated for legislative efforts.

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<sup>12</sup> See SBM’s 21<sup>st</sup> Century Practice [Task Force Report](#).

<sup>13</sup> Strategic Goal 3 requires the development and adoption of a payee notification program in Michigan to support the goal of maintaining “the highest conduct among its members.” [SBM Strategic Plan 2017-2020](#), Adopted by the Board of Commissioners January 20, 2017, and approved by the Representative Assembly on April 22, 2017.

<sup>14</sup> On November 29, 2017, the Negligence Law Section Counsel approved a motion to support the SBM advancing legislation to enact payee notification.

**STATE BAR OF MICHIGAN POSITION**  
**By vote of the Representative Assembly on April 21, 2018**

Should the Representative Assembly adopt the above resolution, proposing state legislation to enact payee notification when a claim is paid with insurance funds?

(a) Yes

or

(b) No

**Attachment 1**  
**Payee Notification Workgroup Members**

**Mark A. Armitage**

- Executive Director, Michigan Attorney Discipline Board
- Actively involved in proactive management-based regulation
- Served on the SBM 21<sup>st</sup> Century Practice Task Force

**Julie H. Pfitzenmaier Cotant**

- Attorney, Wright Beamer, PLC
- Client Protection Fund Committee Member since 2015

**Thomas H. Howlett**

- Attorney, The Googasian Firm PC (represents clients in serious injury cases and class action suits)
- Client Protection Fund Committee Member since 2016

**Diane Hutcherson**

- Attorney, Hom Killeen Arene & Bachrach (represents AAA Insurance)
- Client Protection Fund Committee Member since 2013
- Incoming Client Protection Fund Committee Co-Chair, 2017-2018

**Starr M. Hewitt Kincaid**

- Attorney, Michigan Municipal Risk Management Authority (represents self-insured public entities)
- Client Protection Fund Committee Member since 2009
- Client Protection Fund Committee Co-Chair, 2014-2017

**John J. Lynch, III**

- Attorney, Vandevveer Garzia
- Client Protection Fund Committee Member since 2016

**Peter M. Neu**

- Labor Representative/Counsel, Michigan Association of Governmental Employees
- Client Protection Fund Committee Member since 2011
- Client Protection Fund Committee Co-Chair, 2015-2017

**Rhonda Spencer Pozehl**

- Senior Associate Counsel, Michigan Attorney Grievance Commission
- Primary responsibility for investigation and prosecution of Trust Account Overdraft Notifications to the Grievance Administrator, presenter for the Trust Account seminar three times per year, and primary responsibility for the Grievance Administrators' Receivership Program

**Robert H. Roether, Attorney at Law**

- Principal, Robert H. Roether Attorney at Law
- Regularly handles actions against banks involving fraudulent endorsement

**Mark L. Teicher, Client Protection Fund Committee Member**

- Principal, Law Office of Mark L. Teicher
- Client Protection Fund Committee Member since 2006
- Incoming Client Protection Fund Committee Co-Chair, 2017-2018

**Attachment 2  
Fiscal Implications**

Claims attributable to attorney theft of settlement proceeds from 2003-2017 totaled \$3,058,765.73. The State Bar of Michigan Client Protection Fund paid \$1,213,753.52 to these victims in accordance with reimbursement caps. Consequently, the victims' unreimbursed losses are over \$1,845,012.21.<sup>1</sup> These losses may have been prevented by payee notification. The total paid by the Fund, due to all forms of dishonest conduct during this time-frame was \$6,237,082.66; total losses exceeded \$12,470,358.49.

Between June 2016 and May 2017, the Fund paid \$905,932.69, but losses suffered by claimants totaled \$2,527,711.11, leaving \$1,621,778.42 in unreimbursed losses. To fully reimburse all claimants, the annual assessment would need to be increased to \$64.49 for all active members and \$32.24 for inactive members.

**Claims History and Fund Balance**

Fiscal Year	Total CPF Approved Claims and Total Amount	Fiscal Year End Fund Balance
2007	39 CPF claims totaling \$211,260	\$1,992,437
2008	45 CPF claims totaling \$601,276	\$2,075,883
2009	49 CPF claims totaling \$339,069	\$2,077,622
2010	31 CPF claims totaling \$447,552	\$2,147,401
2011	68 CPF claims totaling \$354,473	\$2,168,624
2012	63 CPF claim totaling \$337,888	\$2,337,719
2013	61 CPF claim totaling \$450,065	\$2,419,173
2014	46 CPF claim totaling \$620,779	\$2,508,917
2015	36 CPF claims totaling \$161,997*	\$2,516,915
2016	67 CPF claims totaling \$912,566.06	\$2,424,698

\*During the 2014-2015 claim year, the final meeting was adjourned and held in the following fiscal year. Therefore, the number is not an adequate representation of the claims approved.

<sup>1</sup> Client Protection Fund Rule 12(B) provides that “the maximum payable to any claimant because of the dishonesty of a single lawyer or group of lawyers acting in collusion, shall be \$150,000.” CPF Rule 12(C) provides that “[t]he aggregate maximum amount for which the Fund shall reimburse losses as the result of the dishonesty of a single lawyer or group of lawyers acting in collusion is \$375,000.”

### **Attachment 3 Representative Respondents**

The Client Protection Fund (CPF) is processing seven claims against one attorney, which allege misappropriation of over \$1.5 million dollars. Additional information and court documents show that there are other victims who did not file claims with the Fund. The attorney was a prominent personal injury attorney and had cases that settled for over one-million dollars. The attorney received checks within days after execution of the settlement agreement, signed his client's names under a power of attorney granted in his standard fee agreement, and deposited the funds into his client trust account. Initially, the attorney told his clients that he only received a small percentage of the settlement proceeds and would remit some funds to the clients to appease them without disclosing that he had received the entire settlement amount. Later, the attorney signed the checks under a power of attorney or fraudulently endorsed them. He did not inform clients that he had received the entire amount of the settlement. The attorney has been criminally convicted.

The CPF is processing 11 claims against one attorney, who allegedly misappropriated over \$241,000; however, the total amount is much higher. This attorney had a small personal injury firm. When settlement checks issued, the attorney forged his client's signature or signed with a power of attorney, deposited the funds into his client trust account, and did not remit them to his clients. The clients were unaware that their attorney had received the settlement checks. Some of the victims received partial recovery from the banks due to the forged documents. The prosecuting attorney's office declined to prosecute this attorney.

Between 2007 and 2009, the CPF received 16 claims against one attorney alleging misappropriation of over \$500,000. Additional information and court documents identified other victims who did not file claims with the Fund. This solo-practitioner was a well-known personal injury lawyer. In the last few years of practice, the attorney routinely settled personal injury matters without the knowledge or consent of his client, forged the client's signature on the settlement agreement and check, and misappropriated the settlement proceeds. The clients were unaware that their attorney had received the settlement proceeds. The attorney was criminally convicted for settling one of his client's cases without the client's authority and failing to disclose and remit any portion of the settlement proceeds to his client. Shortly after the conviction, the attorney took his own life.

In 2005 and 2007, the CPF received 13 claims against one attorney, of which, 9 were approved for reimbursement with a total loss to claimants of approximately \$722,000. In each claim, the attorney was appointed guardian and/or conservator of an estate by the probate court. Respondent systematically misappropriated funds from the estates, including settlement funds from an automobile accident. The attorney was criminally convicted.

Between 2001 and 2003, the CPF received 27 claims for over \$940,000 against one attorney. This general practitioner embezzled funds from estates, personal injury proceeds, personal loss proceeds, and life insurance benefits. In most matters, the attorney under-reported the number of checks issued by the insurance company, forged the payee's signature on the check, and misappropriated the funds for his own use. The extent of the embezzlement was discovered after Respondent unsuccessfully attempted to take his own life. The attorney was criminally convicted.