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The Liability of Financial Institutions to an Attorney's Client When the Attorney Endorses a Settlement Check Without Authorization

DAVID J. COOK

This article explores the scope of an attorney's authority, if any, to endorse a client's name to a settlement check and deposit the check in the attorney's trust account. It also analyzes the bank's liability to the client for conversion under the Uniform Commercial Code and the statute of limitations in these matters.

Every business has its mantras. In real estate, brokers say “location, location and location.” In the construction business, the carpenters say, “Measure twice, cut once.” Attorneys are inclined to admit, under pressure, “When you don’t have the law, argue the facts, and when you don’t have the facts, argue the law.” Bankers have a simpler maxim, “Know your customer.” “If you know your customer,” the bankers say, “you won’t get hurt.”¹ This should work in nearly all cases, with the exception of figuring out who is the customer. When it comes to attorney-client trust accounts, the client might not be the customer; however, the

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money in the account and the settlement checks received by the attorney and deposited into the account belongs to the client. Getting to know each and every client is unlikely (to say the least), and likely does not occur until such time that the banker confronts the client on the witness stand when defending against claims that the attorney, who is the customer of the bank, lacked the authority to affix the client's name on an endorsement on the check, resulting in the bank being sued for conversion for compensatory and punitive damages.²

What a way to make friends. Better to meet the attorney's clients at the attorney's holiday soirée than the trial department of the Superior Court. The tinkling of glasses sounds much better than stone cold inquiries by the judge of what you did to verify that the endorsements on a seven-figure settlement check were genuine. This article will discuss the scope of the authority, if any, imbued in the attorney to endorse a client's name to a settlement check, the liability of the collecting bank in acceptance of the check for deposit and negotiation, and the exposure of the bank to the client for conversion under Uniform Commercial Code ("UCC") Section 3-420.³ The conclusion of this article is that, by terms of an engagement, an attorney lacks the per se authority to endorse the name of the client to a check in the settlement of a lawsuit or claim. Further, pursuant to Section 3420, the financial institution accepting the check is liable to the client in conversion under for the face value of the check.

The vernacular states its better: A powerful attorney is not a power of attorney.⁴

TYPICAL FACT PATTERNS

Many attorneys engage in the practice of personal injury, medical malpractice, legal malpractice, construction litigation, and other cases that generate settlement checks as a matter of course. In these actions, the defendants or their insurance companies will typically make the settlement check payable to the order of the client (the plaintiff in nearly all cases) and the attorney; generally, the payees are listed as "JAMES JONES and MARY SMITH, HIS ATTORNEY," as joint payees.⁵ Under local state law, attorneys are obligated to maintain attorney-client trust accounts des-

ignated as “attorney-client trust account,” “client trust account,” or other similar variation. As a practical matter, the attorney has total control over the account, and makes deposits and withdrawals as the sole signatory. Most trust accounts are “common trust accounts” in which the attorneys deposit checks from an assortment of acts. The banks pay interest on these accounts, but payable to the order of the state bar’s program for services available to the indigent, typically under the name or names of IOLTA.⁶ The banks pay interest on these accounts at the lowest account rate.⁷

Banks may process millions of dollars from attorneys weekly, if not daily, without any adverse repercussions. However, a crisis emerges when an attorney settles a case with or without authority or endorses settlement checks with or without the client’s written authority. In these situations, the attorney without the client’s knowledge or consent settled the case, forged the client’s name to the settlement agreement and settlement check, deposited checks or checks, and absconded with the proceeds. Through the state bar disciplinary process and ensuing client security fund proceeding, the client learns that the attorney illicitly settled the case and came into possession of the settlement check. Other fact patterns are similar in which the client might have authorized the attorney to settle the case, or even signed the settlement, agreement, but not endorsed the check.

The issue here is the authority, if any, of the attorney to affix the client’s name to the settlement check. Many, but not all, retainer agreements provide for a power of attorney with language as follows: “Client authorizes attorneys to affix the name of the client to any draft, check, instrument or other document arising out of the settlement of matter(s) by which the attorney has been retained.”⁸ Other variations abound, but the key language is that the client authorizes the attorney to endorse the client’s name, deposit the check with the attorney’s bank, and receive in the trust account the settlement proceeds. These powers of attorney are very common and many states’ Bar model fee agreement include these terms. As a general matter, a bank would not be liable to the client for conversion if, in fact, the client authorized the attorney in writing to endorse the client’s name to the check. In other words, the bank generally has no liability in conversion because the attorney had the authority to endorse the name of the client, making the negotiation lawful.

Upon learning that the attorney has, in fact, forged the name of the client, and assuming no special or general power of attorney, the client has the following options. The first and most economical option is that the client can make a demand upon the collecting bank for reimbursement by presenting an affidavit of forgery. Most, and nearly all large banks, have established internal security departments that routinely receive affidavits of forgery, open investigatory files, confront the customer attorney, and attempt to determine if, in fact, the signature at issue was a forgery, and if the attorney acted wrongfully and lacked a retainer agreement. Banks sometimes argue that the client is lying;⁹ that the client authorized the attorney to sign his or her name by way of oral authority, or a collateral document which is now long gone; or that the client and attorney are “gaming” the bank.¹⁰ In the event that the bank declines payment, a civil suit surely will follow in which the client will seek compensatory and punitive damages.

The client’s next option is to file a claim with the state bar client trust or security funds.¹¹ Most state bars provide for client security funds to compensate clients for attorney thefts and embezzlement.¹² The client files verified applications asserting an attorney theft; the fund (board, commission or similar entity) investigates the claim, possibly holding a hearing, and then renders an award, consisting of reimbursement due the client. The fund is now subrogated to the client’s rights and files a civil action against the attorney. Depending upon the state statute, the fund will file suit against the collecting bank for the loss based on equitable, contractual, or statutory subrogation principles.

The client security fund’s main advantage is that the fund is non adversarial, requires a modest amount of paperwork, is “no-fault,” and pays off in about 6 to 12 months (or more). The disadvantage is that the fund provides for limited payments¹³ in terms of dollar amount and sometimes is unduly slow.

The client can also recycle the underlying litigation. Typically, the insurance company, or third party, settles the underlying tort case and bargains for a dismissal in return. Assuming that the settlement was unauthorized,¹⁴ the client could move to set aside the dismissal, rescind the mutual releases (potentially forged), and reinstate the underlying litigation.¹⁵ The client would have to credit the final¹⁶ settlement with the funds paid by the de-

fendant (or the insurance company) to the attorney. While the client might suffer diminution of the claim¹⁷ based on the credit for any funds illicitly received by the attorney, many attorney-engineered settlements represent deep discounts, as opposed to a fair settlement for the claims.

The client may also file criminal charges directly through the police or district attorney or through the U.S. Attorney. Courts routinely order restitution as part of a criminal sentence and may render civil judgments against attorneys.¹⁸ Anecdotal experience suggests that attorneys facing serious jail time might well seek to ameliorate their criminal exposure by offering (and fulfilling their duty) to render complete restitution. However, sending the attorney “up the river” will rarely generate recompense due the aggrieved client, other than personal satisfaction, and certainly the criminal process rarely provides the clients with a platform for litigation against third parties, such as banks.

BANK IS LIABLE FOR PAYMENT BASED ON FORGED ENDORSEMENT

A bank or other financial institution is strictly liable for the conversion by deposit or payment based on a forged endorsement under the Uniform Commercial Code Section 3-420. Conversion arises in the event of a deposit without an endorsement or where there is either a forged or unauthorized endorsement. The UCC imposes a duty upon each party in the chain of title to insure that the party, upstream, has in fact title to the item. The tort of conversion is a matter of strict liability and has replaced virtually every other claim, such as negligence, fraud, breach of fiduciary duty, or other claims.

The fact that a bank is liable in conversion for the deposit and collection of proceeds is well established and generally undisputed. The thesis percolating through Articles 3 and 4 of the Uniform Commercial Code has always been to impose a duty upon each party in the transaction to insure that they are receiving good title to an instrument. The rationale in imposing liability upon the parties is that they are in the best position to assure receipt of an instrument with good title, or to reject the item. Despite the use of ATMs, remote deposit strategies, and other non-personal methods

of deposit, the bank remains strictly liable in conversion in the handling of the instrument. Any other rule would break down the door of certainty in transactions and subvert the nature of warranties in passing the instrument down the chain of title. Worse is the specter wholesale money laundering, which would favor criminal syndicates, who could steal checks and forge the name of the payees, reaping the benefits with the collecting bank as the unwitting accomplice in depriving the drawer and drawee of their funds.

While forged endorsements may arise from any number of business circumstances,¹⁹ the rules remain the same, regardless of the business, galloping electronic advancements, or the volume of the checks. The collecting bank is liable to the payee for the cashing, depositing, or negotiation of the check. The payee has a direct right of action against the collecting bank. This specter of clear liability imposes a duty upon the collecting bank to insure that the person presenting the check has properly secured the endorsements or that he holds a power of attorney. Relieving the banks of liability and therefore reducing their level of vigilance would convert the bank into a “money laundering machine,” in which the bank would accept checks, and other negotiable instruments, convert them into money, and remain free of liability.

ATTORNEYS DO NOT HAVE THE AUTHORITY BY THEIR ENGAGEMENT TO ENDORSE THE CLIENT’S NAME TO A SETTLEMENT CHECK

State bars courts issues law license to individuals who, typically, have graduated from college²⁰ and law school;²¹ have taken state administered tests to determine minimum legal knowledge;²² have no criminal history or prior acts of moral turpitude;²³ and have sworn allegiance to uphold the law and the Constitution of the United States. With valid law license in hand the individual is deemed an attorney at law and can represent members of the general public, corporations, and public entities in their legal, financial, and business affairs. The rules of professional conduct lay down basic guides for conflicts, the handling of trust accounts, client funds and retainers, the calculation of attorney’s fees and the relationship with adverse attorney’s parties, and conduct in court. However, neither the rules

of professional conduct nor the state bar or other legislation authorize an attorney to take title to or receive the benefit from the client's property.²⁴ Courts have repeatedly held that attorneys lack the authority to give away, transfer, or surrender the client's substantive rights (such as a client's right to a jury trial).²⁵ Courts have held that attorneys are not *per se* authorized to affix their names to a settlement agreement merely by virtue of their employment. In the seminal case, *Levy v. Superior Court (Golant)*,²⁶ the California Supreme Court squarely held that an attorney cannot affix his or her name to a binding settlement agreement which is subject to enforcement as a final judgment. California has a unique settlement statute in California Code of Civil Procedure Section 664.6.²⁷

The majority rule is that attorneys do not *per se* have the authority to settle a client's case. In a typical fact pattern involving an attorney settling a case without authorization, the attorney forges the client's signature on the settlement agreement and affixes the client's name as an endorsement on the settlement draft. These facts would impose liability upon the bank for conversion under Section 3-420, which provides for strict liability.²⁸ In *Navrides vs. Zurich Insurance Co.*,²⁹ the California Supreme Court carefully parceled out the difference between the authority of the attorney to receive the check from the adverse party, and the additional and different authority of the attorney to endorse the client's name to the check.³⁰ As previously indicated, the court signaled that the financial institution serving as the collecting bank would be strictly liable to the attorney's clients for accepting the check based on a forged or potentially missing endorsement. Given that many retainer agreements contain a power of attorney that would excuse the collecting banks from any liability, the clear demarcation of the collecting bank's liability would appear moot or inaccessible. Certainly, the court had that fact in mind. The client, with knowledge of the bank's strict liability for conversion, would be able to negotiate with the attorney (or find another attorney) and decline to provide a power of attorney. The bank, likewise recognizing its own potential liability for conversion, would demand that the client appear at the bank and endorse the check, demand a specific (and notarized power of attorney) or better yet, decline the deposit.³¹ What *Navrides* does is rearrange the interplay between clients who are seeking to protect their recovery, attorneys who

are seeking to facilitate the orderly receipt and collection of the settlement proceeds, and financial institutions that are seeking to avoid liability for the mishandling of a settlement check. *Navrides* places the responsibility on the financial institutions to ensure that the attorney is authorized as a matter of contract to endorse the client's name to the check or face liability for conversion, and expects clients to be sure to hire honest attorneys if they are executing a power of attorney. From the viewpoint of Adam Smith, *Navrides* is the invisible hand of the market place, pointing out to banks to only do business with honest attorneys who have powers of attorneys, and clients are warned not to give power of attorney to attorneys who are dishonest.

Some states have enacted the Uniform Fiduciaries Law.³² Illinois has adopted the Uniform Fiduciaries Law under the Fiduciary Obligations Act.³³ In the case of *Mikrut v. First Bank of Oak Park*,³⁴ the Illinois Supreme Court held, as a matter of law, that an attorney had the implied authority to endorse his clients' names to checks solely payable to the clients and to deposit the checks in the attorney's trust account.³⁵ The court held that the Fiduciary Obligations Act imbued the attorney with the power to endorse the checks as a matter of law and that, pursuant to UCC Section 3-420, the bank bore no liability.³⁶ *Mikrut* has fierce critics who condemn the Illinois Supreme Court's holding that an attorney-at-law is an attorney in fact.³⁷

Mikrut is an anomaly and its reasoning deeply conflicts with the principles enunciated in support of the enactment of UCC Section 3-420, as well as the consistent body of cases imposing liability on the bank. The drafters of Section 3-420 specifically sought to impose liability upon the financial institution to compel them to ensure that the endorsements are genuine — either because the endorser has affixed his or her name to the check or because the endorser has authorization to indorse the check. Any rule to the contrary would convert the financial institution into a modern-day “enabler” facilitating fraud or embezzlement.

Whether *Mikrut* gains traction has yet to be seen. The answer, interestingly enough, may be found in *Tifton Bank & Trust Company v. Knight's Furniture Co., Inc.*,³⁸ which overruled Georgia's longstanding body of law authorizing attorneys to endorse their clients' names to settlement checks.

The court said that “the public would ‘recoil in horror and deny it’ if told an attorney can lawfully sign his client’s name to a check made payable to the client and then deposit it into his own account even if the client expressly tells the attorney not to do so.”³⁹

Certainly, clients who would be horrified in Georgia would be equally horrified in Illinois. The UCC specifically compels state courts to consider decisions outside of their jurisdiction⁴⁰ and, therefore, tragedy befalling the clients in Tifton is more than just Southern Gothic horror.

STATUTE OF LIMITATIONS

The negotiation and deposit of a check bearing a forged endorsement is a conversion of personal property.⁴¹ Generally, the typical statute of limitations for conversion is three years to four years.⁴²

The battleground for the statute of limitations, particularly in actions relating to conversion of settlement checks, is whether the statute of limitations is tolled based on discovery. The concept of discovery requires parsing. In an action brought by the client against the attorney, the rule of discovery is key to the statute of limitations analysis by effectively creating a tolling assuming the attorney engaged in obfuscation of any kind.

That is not the issue here. In this analysis, the client brings suit against the bank, who presumably took and received the check without the slightest notice of defect in the endorsement and did not engage in any obfuscation. Obviously, the outcome of a statute of limitations urged by a financial institution might be different depending upon the bank’s conduct in engaging in obfuscation. The presumption here is to the contrary.

The accrual issue is unique to attorney defalcation cases. A typical fact pattern involves a client who retains counsel to recover damages in a personal injury or property damage case. Counsel makes a demand or files suit against the wrongdoer who tenders the claim and to the insurance company. Over the course of months, or years, the attorney litigates the case and settles the matter. The client might or might not know about the settlement, and after an interminable number of phone calls to the attorney, contacts the state bar. The state bar engages in its own round of preliminary investigation and through discovery determines that the client’s case has been settled and

that the attorney forged the settlement check. Only during the investigation does the Bar inform the client of the forged endorsement and only because the Bar inquires of the client whether the signature on the back of the check was truly affixed by the client. By that point, a significant amount of time has passed. However, assuming that the loss is not catastrophic (i.e., less than \$50,000), the state bar maintains a client security fund which would partly mitigate the client's losses. A crisis arises when the state statute for conversion has passed and the litigant is either the aggrieved client who has not recovered the total loss from the client security fund or the client security fund itself, seeking to pursue the bank for conversion after the expiration of the statute of limitations for conversion (having passed during the investigation process).

A cause of action for conversion begins running on the date of conversion and delayed discovery will not extend the statute of limitations.⁴³ The fact that a "delayed discovery" is not available to the client serves as substantial impediment to recovery against the bank given the lapse of time between the conversion of the check and the actual discovery by the client, which could be years. In many cases, the client security fund has paid the client for the loss and becomes subrogated to the client's right to file suit against the financial institution. California law authorizes the state bar to file suit against third parties such as the financial institutions to recover on any claim which the client might have sought.⁴⁴ This is the traditional right of subrogation founded in statute, common law, Rule 3.4521 of the Rules of Administration of the Client Security Fund,⁴⁵ and the Client Security Fund Application.⁴⁶

Upon payment of the client's claim, the state bar is subrogated to the rights of the client by virtue of California Business and Professions Code Section 61405(b); the state bar has three years after date of payment to bring suit against the attorney or others, including the financial institutions.⁴⁷ If the claim against the financial institution was "alive" at the time of payment, the state bar has three years plus whatever time was remaining upon the date of payment.⁴⁸ If the claim against the bank expired prior to payment, the state bar's sole rights would lie against the attorney.

CONCLUSION

Million dollar settlements are commonplace, and personal injury, property damage, and wrongful death case payouts frequently breach the \$50,000,000 barrier. Class action settlements roll past the hundred million dollar sign post. Most attorneys are honest, reputable individuals, who handle large sum of money with complete integrity and reliability. However, from time to time, the legal profession has had its bad apples, and some of these apples are rotten to the core. For the bankers, *Navrides* alerts the financial community to exercise great care to ensure that the attorney is authorized to endorse the client's name to a settlement check. Without a valid power of attorney, or other viable defense,⁴⁹ the bank can face major liability.

NOTES

¹ Actually, this is second rule of banking. The first rule of banking is "A good banker makes loans. A better banker collects loans. A great banker collects the loans when due."

² By law, attorneys are obligated to maintain attorney-client trust accounts and every day financial institutions process trust deposits worth millions of dollars. Despite the rise of electronic conveniences, Internet banking, remote check deposit capabilities, ATMs, and other devices enabling an impersonal relationship between banks and customers, the banks remain duty-bound to comply with the mandates of Divisions Three and Four of the UCC upon pain and suffering of civil liability. The conveniences of the electronic age do not immunize financial institutions from civil liability imposed under a statutory framework passed by acts of state legislatures. The Internet does not obliterate US copyright laws nor does overseas manufacturing immolate US patent laws.

³ Uniform Commercial Code (California Commercial Code) Section 3-420 provides as follows:

"3-420: (a) The law applicable to conversion of personal property applies to instruments. An instrument is also converted if it is taken by transfer, other than a negotiation, from a person not entitled to enforce the instrument or a bank makes or obtains payment with respect to the instrument for a person

not entitled to enforce the instrument or receive payment. An action for conversion of an instrument may not be brought by (1) the issuer or acceptor of the instrument or (2) a payee or endorsee who did not receive delivery of the instrument either directly or through delivery to an agent or a co payee.

(b) In an action under subdivision (a), the measure of liability is presumed to be the amount payable on the instrument, but recovery may not exceed the amount of the plaintiff's interest in the instrument.

(c) A representative, other than a depositary bank, who has in good faith dealt with an instrument or its proceeds on behalf of one who was not the person entitled to enforce the instrument is not liable in conversion to that person beyond the amount of any proceeds that it has not paid out."

⁴ "The parties agree on the basic proposition that an attorney must be specifically authorized to settle and compromise a claim." An attorney "has no implied or ostensible authority to bind his client to a compromise settlement of pending litigation and that clearly he has no authority pursuant to an unauthorized settlement to enter a dismissal with prejudice." (*Navrides v. Zurich Ins. Co.* (1971) 5 Cal.3d 698, 702, fn. 1, 97 Cal.Rptr. 309, citations omitted; see also *Blanton v. Womancare, Inc.* (1985) 38 Cal.3d 396, 404, 212 Cal.Rptr. 151.)" *Alvarado Community Hospital vs. Superior Court (Pegg)*, 173 Cal. App. 3rd. 476, 480 (Cal App. 5 Dist. 1985).

⁵ See *Herron vs. State Farm Insurance Co.*, 56 Cal. 2nd 202, 206-207 (1961). Insurance company is liable to attorney if settling directly with the client for purpose of knowingly "cutting out the attorney" and reducing the settlement by avoiding payment of the attorney's contingent fee interest. In light of this case and the fact that the attorney has an equitable or legal interest in the claim itself by way of an attorneys' lien, the insurance company or other obligor prudently would include any person who might have interest in the claim as a payee.

⁶ IOLTA programs pass Constitutional muster. *Brown vs. Legal Foundation of Washington*, 538 U.S. 216 (2003), affirming 271 F. 3rd 835.

⁷ Most state bars have an IOLTA program and banks pay the lowest rate of interest on a "passbook account" [demand deposit account or DDA] to the customer. Attorney-client trust accounts maintain high dollar balances given that attorneys are obligated by the court to impound recoveries pending various contingencies.

⁸ See, e.g., *Rohrbacher vs. BancOhio Nat'l Bank*, 171 F. A.D. 2nd 533, 567 N.Y.S. 2nd 431 (1st Dept., 1991) (retainer agreement provided that "We

hereby authorize you to endorse my name on any check or draft obtained herein, if said check or draft is deposited in your escrow-trust account pending distribution of the proceeds pursuant to the terms of this retainer.”)

⁹ Anecdotal experience suggests that claims filed against the bank for stolen blank checks taken from the customer are the subject of a forged maker signature, and stolen checks payable to the customer in whom the wrongdoer wrongly endorses the customer's name are sometimes perpetrated by the family members, or the confederates of the customer.

¹⁰ While most claims are free of fraud or dishonesty, any claims process will be subject to subversion by claimants given that the obligor (i.e., the bank) necessarily relies on the veracity of the claimants.

¹¹ See California Business and Professions Code Section 6140.5(a); “Finally, we point out that recourse may be available to the Carrolls, and, derivatively, to District and its insurer, under the Clients' Security Fund established by the State Bar pursuant to Business and Professions Code section 6140.5 This section provides:

(a) The board may establish and administer a Client Security Fund to relieve or mitigate pecuniary losses caused by the dishonest conduct of those active members of the State Bar. Any payments from the fund shall be discretionary and shall be subject to such regulation and conditions as the board shall prescribe. The board may delegate the administration of the fund to the disciplinary board provided for in Section 6086.5, or to any board or committee created by the board of governors.”

The fraud and embezzlement that occurred here may be a reimbursable loss caused by the dishonest conduct of an active member of the State Bar acting as fiduciary on behalf of his clients. (*Whittier Union High School District vs. Superior Court (Carroll)*, 66 Cal. App. 3rd 504, 510 (Cal App., 2nd Dist., 1977). See also *State Bar of California vs. Statile*, 168 Cal. App. 4th 650, 660-661 (Cal. App., 1st Dist., 2008).

“The Legislature enacted section 6140.5 in 1971, authorizing the creation of the CSF (*Saleeby v. State Bar* (1985) 39 Cal.3d 547, 555 [216 Cal.Rptr. 367, 702 P.2d 525].)

The purpose of the fund is to compensate victims who have incurred monetary loss as the result of their attorneys' misconduct. (Section 6140.5, sud. (a).) Pursuant to the CSF rules, an applicant may fill out a preprinted form to describe the circumstances surrounding a loss, under penalty of perjury. (CSF rule 13.) In order to qualify for reimbursement from the CSF,

an applicant must establish the loss of money or property which came into the hands of an active member of the Bar by dishonest conduct while the member was acting as a lawyer, trustee, or fiduciary. (CSF rule 2.) “[D]ishonest conduct” includes, among other things, “[w]rongful acts committed by a lawyer in the nature of theft or embezzlement of money or the wrongful taking or conversion of money or property.” (CSF rule 6(a).) Before the CSF Commission directs payment from the fund, it must find that a reimbursable loss has been established by a preponderance of the evidence. (CSF rule 15(e).) After an application is screened, the CSF Commission tentatively decides what action should be taken, and its tentative decision is served on the applicant and the lawyer whose actions led to the applicant’s loss. (CSF rule 14(c).) The parties then have 30 days to file any written objections to the proposed recommendations and request a hearing, if desired. (CSF rule 14(c).) The CSF then takes final action on the application, which may include directing reimbursement from the fund. (CSF rule 15(a), (b).) An attorney or an applicant may seek review in superior court of the final decision of the CSF to grant or deny reimbursement pursuant to Code of Civil Procedure section 1094.5. (CSF rule 17.)”

“All payments from the [CSF] shall be a matter of grace and not of right and shall be in the sole discretion of the State Bar of California. No client or member of the public shall have any right in the Fund as a creditor, third party beneficiary, or otherwise.” (CSF rule 2(d).) Payment to an applicant is conditioned upon a “pro tanto assignment from the applicant of the applicant’s rights against the lawyer involved and against any third party or entity concerning the dishonestly caused loss for which the applicant is receiving reimbursement from [CSF].” (CSF rule 19.) The State Bar is statutorily subrogated to the extent of payment to the rights of a victim against the person or persons who caused the pecuniary loss. (§ 6140.5, *sud.* (b).)”

¹² Client security funds are typically organized and maintained by the state bar. *See for example, Saleeby vs. State Bar of California*, 39 Cal. 4th 547 (1985) which details the history of client security funds (555-556) and held that the State Bar must provide for a set of rules in conformity with basic due process in the administration and payment of claims. (562-567).

¹³ “Where an attorney purports to accept a settlement offer without his client’s consent, the client has two options. First, the client may decide the unauthorized settlement was nonetheless a beneficial bargain and seek to ratify his attorney’s acceptance. Alternatively, the client may determine the

settlement was not beneficial, seek to disavow it and proceed with a lawsuit.” *Alvarado Community Hospital vs. Superior Court (Pegg)*, *Id.* at 480.

¹⁴ As opposed to the settlement being authorized with the endorsement of the client's name to the check being the sole unauthorized act.

¹⁵ *Alvarado Community Hospital vs. Superior Court (Pegg)*, 173 Cal. App. 3rd 476, 484 (1985). This case is interesting in that the client sought payment from the Client Security Fund. The client also sought to reinstate the underlying action probably premised on the fact that the illicit settlement was for pennies on the dollar, and that active pursuit against the tort defendant might generate a better result than the recompense paid by the client security fund. In this case, the court provided the client with a pass from the prospect of ratification of settlement: “We have decided the best method of spreading the economic loss caused by Bambic's dishonesty is to allow Pegg the opportunity to refund \$9,000 to CSF as a condition of her pursuing her action against Alvarado. Thus, to the extent possible the parties will be placed in the position they would have been had Bambic never been involved. Now, if Pegg refunds the \$9,000 and successfully pursues her action against Alvarado, Alvarado will be entitled to \$15,000 plus interest as a set-off against the judgment. If Pegg is unsuccessful Alvarado is derivatively entitled to recoup its \$15,000 from CSF. For these reasons our holding in this case shall be prospective only.”

¹⁶ *Whittier Union High Sch. Dist. v. Superior Court* (1977) 66 Cal.App.3d 504, 136 Cal.Rptr. 86, presents a similar fact pattern except that instead of suing to recover the settlement proceeds, the plaintiffs sought to have the unauthorized dismissal set aside and to proceed with their lawsuit. The court held that an unauthorized dismissal is voidable for an indefinite period and that the client is entitled to have such a dismissal vacated within a reasonable time after learning of it. (*Id.*, at pp. 507-508, 136 Cal.Rptr. 86.) (*Alvarado Community Hospital vs. Superior Court (Pegg)*, *Id.* at 481) In *Whittier Union High School vs. Superior Court*, *id.*, the court set aside the dismissal but credited the plaintiff's loss by way of the embezzled settlement funds against the final settlement or judgment. *Id.* at 509-510.

¹⁷ The client might have a “crime policy” which could cover the loss. The attorney might have malpractice coverage. It is not likely that the attorney's coverage would indemnify the client for any embezzlement or fraud, but it is more likely that the insurance might cover any negligence in the settlement of the action, and the payment of the settlement, incidentally received by the attorney.

¹⁸ See California Penal Code Section 1214(b) which provides as follows: “In any case in which a defendant is ordered to pay restitution, the order to pay restitution (1) is deemed a money judgment if the defendant was informed of his or her right to have a judicial determination of the amount and was provided with a hearing, waived a hearing, or stipulated to the amount of the restitution ordered, and (2) shall be fully enforceable by a victim as if the restitution order were a civil judgment, and enforceable in the same manner as is provided for the enforcement of any other money judgment.”

¹⁹ Construction has its fair share of forgeries based on the fact that owners, general contractors, financiers, and disbursing agents regularly issue “joint payee checks” in which one of the joint payees takes matters into their own hands, much to the disappointment (and loss) of the other payee. In construction damages cases, insurance companies, issuing joint payee checks, likewise confront wholesale claims of forgeries.

²⁰ From state to state, a college education is not required.

²¹ A handful of states will substitute education at an attorney’s office, as opposed to a law school education. Up to and even through the 20th century, individuals received their education working in a law office as opposed to attending law school.

²² Common bar passage rates are 70 percent. This might cause the general public concern that a licensed attorney might be ignorant of 30 percent of the law, and the client’s problem might fall into that 30 percent.

²³ The current generation should use extreme caution when frequenting social networking sites and other popular internet sites to avoid conduct which could be construed as inappropriate, imprudent or morally questionable conduct. Common sense and modern technology would suggest that today’s bar examiners might “google” bar applicants for any potentially derogatory information. Online photos of bar applicants throwing stones at police officers, vandalizing property, publishing statements suggestive of the overthrow of the government, or personal conduct inconsistent with decent morals might catch someone’s attention.

²⁴ The most recent related analysis is *Fletcher vs. Davis*, 33 Cal. 4th 64 (2004), which barred attorneys from seeking a charging lien in the client’s property based on an hourly retainer agreement. The court held that the lien gave the attorney control over the client’s property and in effect converted the attorney from agent to partners with the right of control over the client’s property. The court stated as follows: “In sum, a charging lien grants the

attorney considerable authority to detain all or part of the client's recovery whenever a dispute arises over the lien's existence or its scope. That would unquestionably be detrimental to the client." [citation omitted] [An adverse interest exists where the fee arrangement "gives the attorney an ownership interest in client property that has a value *greater* than the amount absolutely agreed upon in fees" (italics added).] A charging lien is therefore an adverse interest within the meaning of rule 3-300 and thus requires the client's informed written consent. Requiring the client's informed written consent has the additional benefit of ensuring that the client truly agrees to the creation of the lien and its scope, thus making it less likely that a disagreement will arise that could lead to litigation or other action adverse to the client, and also impressing upon the client the importance of his or her consent and of the right to withhold it. [citation omitted] *Id.* at 70.

²⁵ The dividing line is whether the rights which the attorney waived or surrendered are "procedural" or "substantive." *See*, for example, "Examples of litigation actions affecting the client's substantial rights include stipulations (1) to the settlement of a lawsuit (*Levy, supra*, 10 Cal.4th at p. 583); (2) to binding arbitration and the consequent waiver of "all but minimal judicial review" (*Blanton, supra*, 38 Cal.3d at p. 407; *see also Lazarus v. Titmus* (1998) 64 Cal.App.4th 1242, 1249 [75 Cal.Rptr.2d 676]); (3) to the waiver of trial testimony and the submission of the case to a judge based on testimony given before a different judge in prior proceedings ending in a mistrial (*Linsk v. Linsk, supra*, 70 Cal.2d at pp. 278-279); (4) to the conveyance of the client's property to his spouse in a dissolution proceeding (*Woerner v. Woerner* (1915) 171 Cal. 298, 299); (5) to the dismissal of the client's complaint (*Whittier Union High Sch. Dist. v. Superior Court* (1977) 66 Cal.App.3d 504, 507-508 [136 Cal.Rptr. 86]) or cross-complaint (*Bowden v. Green* (1982) 128 Cal.App.3d 65, 73-74 [180 Cal.Rptr. 90]); (6) to the entry of summary judgment against the client (*Roscoe Moss Co. v. Roggero* (1966) 246 Cal.App.2d 781, 786-787 [54 Cal.Rptr. 911]); (7) to the fact that the employer's premises constituted an unsafe workplace, thereby disposing of the workers' compensation insurer's sole interest in the litigation, i.e., its lien rights (*Harness v. Pacific Curtainwall Co.* (1965) 235 Cal.App.2d 485, 491 [45 Cal.Rptr. 454]); (8) to the entry of a default judgment (*Ross v. Ross* (1953) 120 Cal.App.2d 70, 74); and (9) to the elimination of a client's essential defense (*Fresno City High School Dist. v. Dillon* (1939) 34 Cal.App.2d 636, 646-647)." (from *Stewart vs. Preston Pipeline* 134 Cal. App. 4th 1565, 1582 (Cal. App 6th Dist. 2005).

²⁶ *Levy vs. Superior Court (Golant)*, 10 Cal. 4th 578 (2002).

²⁷ C.C.P. Section 664.6.

²⁸ *Kenerson vs. FDIC*, 44 F. 3rd 19, 35-37, 25 UCC Rept. 2nd 401(1st Circuit, 1995) *Navrides vs. Zurich Insurance Company*, 5 Cal. 3rd 698, 705 (1971) which held that the third party (obligor) was authorized to deliver the check to the attorney, but the attorney was authorized by virtue of his engagement to endorsement check and receive the proceeds. The court cogently spelled out the liability of the collecting bank as follows: "We emphasize that by commencing the present action plaintiff ratified the entire transaction between Forsyth and Zurich. But her ratification did not necessarily extend beyond the consummation of the settlement so as to include events transpiring after Forsyth received the draft and encompass ratification of the unauthorized endorsement of her signature on the draft.

A payee, whose endorsement has been forged subsequent to the delivery of a check to the payee or his agent, can sue the collecting bank in conversion. Since a forged endorsement is wholly inoperative, the collecting bank acquires no right to retain the check or to enforce its payment against the drawee bank by virtue of the forged endorsement. However, the payee may in a limited sense ratify the bank's Collection of the amount of the check from the drawee bank and then sue the collecting bank in conversion for paying this amount to the forger. (*Fabricon Products v. United Cal. Bank* (1968) 264 Cal.App.2d 113, 116--117, 70 Cal.Rptr. 50; *Indiana Plumbing Supply Co. v. Bank of America* (1967) 255 Cal.App.2d 910, 915, 63 Cal.Rptr. 658; *Palo Alto etc. Ass'n v. First Nat. Bank* (1917) 33 Cal.App. 214.) Thus, the payee is allowed a selective ratification as it were; he may ratify the collection of the amount of the check from the drawee bank by the collecting bank on the forged endorsement, but is not required to ratify the forged endorsement in toto and thereby approve payment to the forger. We know no reason why this doctrine of selective ratification is inappropriate in this case, so we need not hold plaintiff to ratification of her unauthorized endorsement on the draft." (Emphasis added).

In accord: *The Florida Bar vs. Allstate Insurance Company* 391 So. 2nd 238,239-240 (Florida Court of Appeals, 981), *Addley vs. Beizer* 205 Ga. App. 714, 423 S. E. 2nd 398, 403 (Ga. Court of Appeals, 1992); *Tifton Bank and Trust Company vs. Knight's Furniture Company Inc.*, 215 Ga. App. 471, 452 S.E. 2nd 218, 222 (Ga. Court of Appeals, 1993); *Pearcy vs. First Nat. Bank in Wichita* 167 Kan. 696, 205 P. 2nd 217, 220 (1949); *Morris vs. Ohio Casualty*

Insurance Company 35 Ohio St. 3rd 45, 517 N.E. 2nd 904, 908 (Ohio, 1988) (“Accordingly, we hold that an attorney, absent any express authority from his client, has no authority to endorse the client’s name on a check or draft tendered to effect a settlement.”); *Third National Bank & Trust Co., Diamond Savings and Loan Co.* 43 Ohio App. 3d 140, 540 N.E. 272, 275 (Ohio, 1987), citing *Central Bank Co. vs. Hahn-Jacobson Co.* (App, 1935) 20 Ohio Law Abs. 433, 4 O.O. 509, 334 N.E. 2nd., 388; *Moran vs. Loeffler-Greene Supply Company* 316 P. 2nd 132, 138-139 (Supreme Court, Oklahoma, 1957) (No implied power to affix client’s endorsement to check.); however, see *Dacus vs. Maryland Casualty Company* 55 P. 2nd 663, 666 (Supreme Court, New Mexico, 1936) (implied authority to indorse checks); *Titus vs. Commercial Bank, Douglasville Georgia* 214 Ga. Ap. 657, 448 S.E. 2nd (Ga. App., 1994) following *John Bean Mfg vs. Citizens Bank*, 60 Ga.App. 615, 617-618, 4 S.E. 2nd 924 (1939) *Pope vs. State*, 179 Ga. App. 7390741, 347 S.E. 2nd 703. See also *Trust Co. Bank vs. Henderson* 185 Ga. App. 367, 368-369, 364 S.E. 2nd 289. (Attorney authorized to endorse client’s name to check). 295 Cal. 3d. 698, 705 (1971).

³⁰ The quintessential facts in any attorney forgery case: “On September 25, 1964, the settlement draft, bearing the purported endorsements of plaintiff and Forsyth, was cashed at the Bank of America and eventually charged to Zurich’s account with the Continental Illinois National Bank and Trust Company of Chicago (Continental Bank). Plaintiff’s signature on the release and her endorsement on the draft were forgeries. She received no money from the settlement. About a year later, plaintiff discovered that her personal injury action had been dismissed and that the above settlement draft had been delivered to her attorney. She was unable to effect any recovery from the latter.” *Id.*, p. 702. Instead of suing the bank for conversion (a probable winner absent a power of attorney under UCC Code Section 3-420), or setting aside the dismissal and reviving the case under *Whittier Union High School District vs. Superior Court (Carroll)* 66 Cal App. 3 504, 508-509 (Cal. App. 2nd Dist. 1977), the client sued the insurance company and the insurance company who issued the check. The court sustained the demurrer on the claim against the bank. The California Supreme Court held that while the settlement was unauthorized and void, the filing and prosecution of the action against the drawer of the check ratified the settlement including the collection of the collection of the funds by the attorney. “We now apply the foregoing rule to the case at bench. As we have explained, plaintiff by bringing suit against Zurich

ratified the compromise settlement of her claim by her attorney, Forsyth, and thus approved his receipt of payment by means of the settlement draft. It is uncontested that Continental, the drawee bank, paid the draft and charged the amount thereof to Zurich.” *Id.* at 712. *See also* 49 ALR3rd. 843-871 (“Discharge of Debtor who makes payment by delivering check payable to creditor to latter’s agent, where agent forges creditor’s signature and absconds with proceeds”).

³¹ Million dollar settlement checks make the bankers nervous.

³² The Uniform Fiduciary Law has been adopted by Alabama, Arizona, Colorado, Hawaii, Idaho, Illinois, Indiana, Louisiana, Maryland, Minnesota, Missouri, Nevada, New Jersey, New Mexico, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Dakota, Tennessee, Utah, Wisconsin, Wyoming, Washington, D.C., and the U.S. Virgin Islands.

³³ 760 ILCS 65/9.

³⁴ *Mikrut v. First Bank of Oak Park*, 359 Ill.App.3d 37, 295 Ill.Dec. 225, 832 N.E.2d 376 (2005).

³⁵ *Mikrut* at 393. “The Act relieves the depository bank of the duty of seeing that funds are properly applied. It becomes the principal’s burden to employ honest fiduciaries. [citation omitted].”

³⁶ “If a deposit is made in a bank to the credit of a fiduciary as such, the bank is authorized to pay the amount of the deposit or any part thereof upon the check of the fiduciary, signed with the name in which such deposit is entered, without being liable to the principal, unless the bank pays the check with the actual knowledge that the fiduciary is committing a breach of his obligation as fiduciary in drawing the check or with knowledge of such facts that its action in paying the check amounts to bad faith. If, however, such a check is payable to the drawee bank and is delivered to it in payment of or as security for a personal debt of the fiduciary to it, the bank is liable to the principal if the fiduciary in fact commits a breach of his obligation as fiduciary in drawing or delivering the check.” *Mikrut* at 390.

³⁷ *Leeds v. Chase Manhattan Bank*, 331 N.J. 416, 752 A.2d 332 (2000) (interpreting *N.J.S.A.* 12A:4-105b and 12A:3-420 [New Jersey’s adoption of UCC Section 3-420] “As a depository bank under the Uniform Commercial Code...Chase is strictly liable for conversion on a forged or stolen instrument. [citing to N.J. Lawyer’s Fund at *id.*]”).

³⁸ *Tifton Bank & Trust Company v. Knight’s Furniture Co., Inc.*, 215 Ga. App. 471, 452 S.E.2d 218, 222 (Ga. Ct. App. 1993).

³⁹ *Id.* at 473 (quoting *Vandiver v. McFarland*, 179 Ga. App. 411, 413, 346 S.E.2d 854 [Ct. App. 1986]).

⁴⁰ 1 FREDERICK H. MILLER, AMELIA H. BOSS, *THE ABCS OF THE UCC: GENERAL PROVISIONS 23-24* (American Bar Association 2002).

⁴¹ Section 3-420(a) “The law applicable to conversion of personal property applies to instruments. An instrument is also converted if it is taken by transfer, other than a negotiation, from a person not entitled to enforce the instrument or a bank makes or obtains payment with respect to the instrument for a person not entitled to enforce the instrument or receive payment. An action for conversion of an instrument may not be brought by (1) the issuer or acceptor of the instrument or (2) a payee or indorsee who did not receive delivery of the instrument either directly or through delivery to an agent or a copayee.” The UCC comment reiterates that the law conversion applies to instruments: “It is better to allow such cases to be governed by the general law of conversion that would address the issue of when, under the circumstances prevailing, the presenter’s right to possession has been denied.”

⁴² California Code of Civil Procedure Section 338(c) (three years) and 13 Pa [Pennsylvania] Cons. Stat. Ann. Section 3118(g) (three years). *See also Aprile vs. Suncoast Schools Federal Credit Union*, 596 So. 2nd 1290, 19 UCC Rep. Serv. 2nd 253 (Fla. App., 1993 (three years)) “ Under Code of Civil Procedure, section 338, subdivision (c), which applies to the conversion of personal property, there is a three-year limitations period for “action[s] for taking, detaining, or injuring any goods or chattels.” Under California law, the general rule is well established: “[T]he statute of limitations for conversion is triggered by the act of wrongfully taking property.” (*Bono v. Clark* (2002) 103 Cal.App.4th 1409, 1433 [128 Cal.Rptr.2d 31]; *see also Strasberg v. Odyssey Group, Inc.* (1996) 51 Cal.App.4th 906, 915-916 [59 Cal.Rptr.2d 474] (*Strasberg*) [“it is the act of wrongfully taking the property which triggers the statute of limitations”], citing *Coy v. E. F. Hutton & Co.* (1941) 44 Cal. App.2d 386, 390 and *First National Bk. v. Thompson* (1943) 60 Cal.App.2d 79; *see also Rose v. Dunk-Harbison Co.* (1935) 7 Cal.App.2d 502, 505-506.)” *Amerus Life Insurance Company vs. Bank of America*, 143 Cal. App. 4th 631, 639 (Cal App. 2nd District, 2006).

⁴³ “Moreover, the decided majority of jurisdictions” has refused to apply the discovery rule to claims for conversion of instruments, “except where the defendant invoking the statute of limitations engaged in fraudulent concealment.” (*Rodrigue v. Olin Employees Credit Union* (7th Cir. 2005) 406

F.3d 434, 445 (*Rodrigue*.) In *Rodrigue*, the 7th Circuit collected the decisions supporting the majority and minority rule, and explained the strong policy concerns militating against a broad discovery rule. (*Id.* at 445-447; *see also Menichini v. Grant* (3d Cir. 1993) 995 F.2d 1224, 1230-31.) “The rationale most often cited in support of the majority perspective is that application of the discovery rule would be inimical to the underlying purposes of the UCC, including the goals of certainty of liability, finality, predictability, uniformity, and efficiency in commercial transactions. In keeping with those goals, negotiable instruments are intended to function efficiently, and liability on those instruments is not meant to be open-ended.” (*Rodrigue, supra*, 406 F.3d at 445-446.) It is well recognized that “[t]he purpose of the California Uniform Commercial Code...is to simplify and clarify the law governing commercial transactions in a uniform manner among the various jurisdictions.” (*Gil v. Bank of America, Nat. Ass’n* (2006) 138 Cal. App. 4th 1371, 1375 [42 Cal. Rptr. 3d 310], fn. omitted (*Gil*.) As the majority rule is consistent with our courts’ precedent, we see no reason not to apply it.” *Amerus Life Insurance Company vs. Bank of America, Id.*, p. 640

⁴⁴ California Code of Civil Procedure Section 6140.5(b) “Upon making a payment to a person who has applied to the fund for payment to relieve or mitigate pecuniary losses caused by the dishonest conduct of an active member of the State Bar, the State Bar is subrogated, to the extent of that payment, to the rights of the applicant against any person or persons who, or entity that, caused the pecuniary loss. The State Bar may bring an action to enforce those rights within three years from the date of payment to the applicant.”

⁴⁵ Rule 3.4521 (formerly Rule 19) of the Rule of Administration of the Client Security Fund. “Any attorney must repay the Fund for any reimbursement, with simple interest and an assessment of processing costs.”

⁴⁶ *See also State Bar of California vs. Statile* 168 Cal. App. 4th 650, 651 (Cal. App., 1 Dist., 2008) “The parties disagree over what subrogation rights the bar acquired against Statile when the CSF paid the Barbettini trusts and Nicholas on their claims. Section 6140.5, subdivision (b) provides: ‘Upon making a payment to a person who has applied to the fund for payment to relieve or mitigate pecuniary losses caused by the dishonest conduct of an active member of the State Bar, the State Bar is subrogated, to the extent of that payment, to the rights of the applicant against any person or persons who, or entity that, caused the pecuniary loss. The State Bar may bring an

action to enforce those rights within three years from the date of payment to the applicant.' The trial court concluded, and Statile argues on appeal, that because the settlement agreement limited the rights of the Barbettini trusts and Nicholas to recover from Statile, the State Bar's recovery pursuant to its subrogation rights likewise was limited by the settlement agreement. The State Bar argues that the settlement agreement did not so limit its subrogation rights. This is apparently an issue of first impression, as we have found no cases addressing a situation where parties settled a lawsuit but preserved the right of the plaintiff to seek reimbursement from the CSF. We begin by setting forth the general principles of subrogation.

"Subrogation, a legal fiction, is broadly defined as the substitution of one person in the place of another with reference to a lawful claim or right. It is a right which is purely derivative and it permits a party who has been required to satisfy a loss created by a third party's wrongful act to step into the shoes of the loser and pursue recovery from the responsible wrongdoer. Stated another way, it is a substitution of one person in place of another with reference to a lawful claim, demand or right, so that he who is substituted succeeds to the rights of the other in relation to a debt or claim, and its rights, remedies, or securities." (73 Am.Jur.2d (2001) Subrogation, Section 1, pp. 541-542, fns. omitted.) "Statutory subrogation,' as its name suggests, arises by an act of the legislature that vests a right of subrogation with a party or category of parties, and it is governed by the terms of the statute under which it is claimed as a matter of statutory construction." (*Id.* at 544-545, fns. omitted.) "The nature of subrogation and its prohibition against double recovery make it abundantly clear that subrogation involves succession to the rights of others. Rights under subrogation are derivative rights, and succession to another's rights, like water, cannot rise higher than its source.'" (*Board of Administration v. Glover*, (1983) 34 Cal.3d 906, 915 [196 Cal.Rptr. 330, 671 P.2d 834], quoting *Ventura County Employees' Retirement Association v. Pope* (1978) 87 Cal. App.3d 938, 952 [151 Cal.Rptr. 695].) "The 'true nature of subrogation' is that 'it is applied in all cases in which 'one party pays a debt for which another is primarily answerable, and which, in equity and good conscience, should have been discharged by the latter.'" (*Fireman's Fund Ins. Co. v. Wilshire Film Ventures, Inc.* (1997) 52 Cal.App.4th 553, 558 [60 Cal.Rptr.2d 591].) It is abundantly clear here that Statile was primarily answerable for any loss suffered by the applicants and, in equity and good conscience, should have been the one to discharge it. (*Ibid.*)"

⁴⁷ “...The State Bar may bring an action to enforce those rights within three years from the date of payment to the applicant.”

⁴⁸ Upon payment, the Bar receives by way of statutory assignment, Rule 19, and CSF contract, the client’s rights against the attorney and banks and has three years, in addition, by which to file suit on those claims.

⁴⁹ In Client Security Fund litigation, the financial institution claim that the State Bar is a compensated insurer and subject to the bar of the Doctrine of Superior Equities, found in *Meyers vs. Bank of America* 11 Cal. 2nd 92 (1938), which holds that a fidelity insurer (today’s crime policy) insuring against an employer in which the loss was an employee theft, was barred in a suit against the bank for conversion. The California Supreme Court held that the insurance company, who was paid to assume the risks borne the employer, was barred in the action against the bank whose fault was “technical.” The Doctrine of the Superior Equities does not apply in CSF matters because the State Bar is mandated by statute to provide a fund to ameliorate the losses sustained by members of the general public at the hands of dishonest attorneys, and Section 6140.5(b) provides the State Bar with the rights of the client in suit against all liable parties.