

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

IN RE ATTORNEY DISCIPLINE SYSTEM;)
CALIFORNIA RULE OF COURT, RULE 9.9)
_____)

S237081

REPORT OF SPECIAL MASTER
NOVEMBER 18, 2016 THROUGH MARCH 31, 2017



SUPREME COURT
FILED

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Jorge Navarrete Clerk

PREPARED BY

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Court of Appeal of the State of California
Second Appellate District, Division One
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SPECIAL MASTER FOR OVERSIGHT
OF THE ATTORNEY DISCIPLINE FUND
OF THE STATE BAR OF CALIFORNIA

INTRODUCTION

In compliance with rule 9.9 of the California Rules of Court, I submit this first quarterly report to the Court as Special Master charged with supervision and oversight of the collection, disbursement, and allocation of the interim special regulatory assessment ordered by the Court on November 17, 2016. In this report, I summarize the steps I have taken to implement the special regulatory assessment, including my oversight of the issuance of fee statements to all active and inactive members of the State Bar and the establishment of the Special Master's Attorney Discipline Fund. I summarize the initial steps and processes I have instituted to monitor fee collections, cash flow, and fund disbursements. I also review budgetary changes and actual expenses within the portion of the attorney discipline system funded by the assessment over the first three months of the year, and provide updates on implementation of the workforce plan within the Office of Chief Trial Counsel and on the project to design and implement a new disciplinary case management system.

A. Special regulatory assessment and Special Master's Fund

Upon my appointment effective November 17, 2016, I immediately began working with State Bar staff to ensure that the 2017 Membership Fee Statements would include proper billing for the Court-ordered \$297 per active member mandatory regulatory assessment and that the statements would issue as soon as practicable. Pursuant to an earlier decision by the Board of Trustees authorizing online-only fee statements for the first time, Notices of 2017 Fee Statements were emailed to all members on December 8, 2016 with instructions for accessing the fee statements through each member's "My State Bar Profile" page on the State Bar website.¹ Pursuant to the Court's order, the deadline for payment of fees was set for March 1, 2017.

On November 28, 2016, I established a public funds commercial checking account entitled "Special Master's Attorney Discipline Fund" (Special Master's Fund) with Wells Fargo Bank to ensure the monies collected from the special assessment were segregated from other State Bar funds. I also arranged for Wells Fargo to provide me and Jorge Navarrete, Court Administrator and Clerk, with SecurID tokens to access the account remotely and in-person training on use of the Wells Fargo secure online portal. The State Bar began depositing assessment revenues into the account starting on December 22, 2016.

In the preamble to its November 17 order, the Court stated "the order is not intended to preclude the State Bar from collecting mandatory fees currently authorized by

¹ Pursuant to California Rules of Court, rule 9.7, all members are required to maintain current contact information on the My State Bar Profile page, including a specific email address, for State Bar communications.

statute or from seeking voluntary member donations for activities not funded by the assessment.” Thus, in addition to billing the Court-ordered \$297 per active member assessment, the State Bar also included in its fee statement a \$25 per member (active and inactive) fee to support the discipline system as authorized by Business and Professions Code section 6140.6, and a \$65 fee per inactive member fee as authorized by section 6141. The State Bar pledged in its Request for Special Regulatory Assessment (Request) to use all of the estimated \$8.3 million in funds generated by these two fees, as well as a projected \$2.1 million in fees and penalties levied for late payments, as supplemental support for the discipline system in 2017.² Therefore, I directed the State Bar to include these fee payments in the regular deposits to the Special Master’s Fund account to ensure the proceeds were properly directed to the discipline system.

B. Cash flow management and fund disbursements

As the court will recall, the special regulatory assessment was directed toward maintaining, operating, and supporting specified components of the State Bar’s attorney discipline system: the Office of Chief Trial Counsel (OCTC), including efforts to implement recently issued workforce plan recommendations from the National Center for State Courts (NCSC); the State Bar Court (SBC); the Office of Probation (Probation); the Mandatory Fee Arbitration program (MFA); the Office of Professional Competence (OPC); the Office of General Counsel (OGC); the Office of Member Records and Compliance (MRC); Member Billing (MB); the discipline related activities of the California Young Lawyers Association (CYLA); the activities of the Office of Communications (OC) in support of the discipline system; and overhead functions necessary to support the discipline system. For shorthand, I will refer to these as the “P-2 programs,” which corresponds to Appendix P-2 to the State Bar’s Supplement Submission Concerning Methodology of Options for a Special Assessment to Fund the State Bar (Supplemental Submission) that contains a set of preliminary 2017 budgets for these programs.

² The Court will recall the State Bar also committed to support the discipline system by dedicating an estimated \$3.2 million in “other revenues” that it intends to collect throughout 2017. These other revenue sources are listed in Appendix A to the State Bar’s *Spending Plan*, which was submitted to the Legislature on May 16, 2016, and attached to the Request as Appendix C (e.g., these other revenues include law corporation and LLP registration and renewal fees, ethics school class fees, investment income, etc.). The support provided by these other revenues will make up an estimated 4.85 percent of the discipline system expenses in the coming year. Because only a portion of these funding sources will be used to support the discipline system and the revenue collections are spread out throughout the year, I have not directed the State Bar to deposit these monies into the Special Master’s Fund. Nevertheless, I have accounted for these funds in calculating the monthly distributions from the Special Master’s Fund, and I have and will continue to monitor the use of these funds to ensure adequate support for the attorney discipline system.

In late November 2016, I directed the State Bar to prepare a projected monthly cash flow analysis in order to better understand the funding needs for these P-2 programs throughout 2017 and to facilitate down-the-road expense monitoring. I also asked the State Bar to use this cash flow analysis to propose a schedule for disbursements from the Special Master's Fund throughout the year. From December 2016 through January 2017, I worked with staff to refine the monthly cash flow projections and disbursement schedule to align with changes to the overall 2017 State Bar Budget, which was approved by the Board of Trustees on January 26, 2017, and submitted to the Legislature on February 15, 2017, in accordance with Business and Professions Code section 6140.1. Based on the final 2017 State Bar budget and our projected cash flow analysis, we anticipate that the total costs of the P-2 programs for the coming year (personnel, operating expenses, and allocated overhead expenses combined) will be approximately \$68,011,932. The breakdown of funding sources for these expenses are as follows: \$55,462,800 from the Court-ordered special regulatory assessment; \$5,675,500 from the discipline assessment (§ 6140.6); \$2,595,300 from inactive member fees (§ 6141); \$2,106,000 from member late fees and penalties; and \$2,172,332 from other revenue sources.

From December 22, 2016, to March 31, 2017, deposits to the Special Master's Fund totaled approximately \$59,048,000, representing 89.7 percent of all anticipated deposits for the year.³ Since the beginning of the year, I have made four disbursements from the Special Master's Fund to support the attorney discipline system: \$5,020,000 on December 29, 2016; \$5,168,000 on January 26, 2017; \$5,100,000 on February 28, 2017; and \$5,030,000 on March 30, 2017. As of March 31, 2017, the ending balance of the Special Master's Fund stood at \$38,730,000.

Monthly cash flow needs for the P-2 programs vary due to a number of factors, but the main driver is personnel expenses, which make up nearly half of all expenses. Looking forward, I anticipate the State Bar will require a higher disbursement from the Special Master's Fund for the months of May and November (approximately \$6,996,045 and \$6,996,066, respectively), because three pay periods end in both of these months.

³ Given that most of the revenue collection was completed in the first quarter of the year, I have started exploring the possibility of purchasing conservative short term investments, such as U.S. Treasury Bills, with an eye toward maintaining the value of the fund balance, and perhaps even generating modest investment income over the course of the year. However, unlike in 1999 when I pursued a similar strategy and the prevailing prime rate was around 8 percent, we have been experiencing historically low interest rates for several years now, and even taking into account the most recent action by the Federal Reserve Bank to raise rates, the current prime rate stands at only 4 percent. Nevertheless, I will continue to weigh the costs and benefits of investing some portion of the Special Master's Fund to obtain a reasonable rate of return and will make recommendations to the Court in due course.

The scheduled disbursements for the remaining six months of 2017 will likely range between a low of \$4,605,745 for May and a high of \$5,605,746 for October.⁴ However, I will continue to follow actual expenses and changes to projected expenses, and make appropriate adjustments as needed.

C. Brief summary of the State Bar's 2017 budget

Before reviewing the P-2 programs' actual expenses against the budget for the first three months of the year, a few aspects of the State Bar's overall 2017 budget bear mentioning for purposes of context.⁵ State Bar spending in 2017 is projected to be approximately \$165 million.⁶ This represents a total spending increase of 13 percent over the 2016 budget of \$146.1 million. In order to fund this spending increase, the Board approved the use of \$19 million drawn from the reserves across multiple sub-funds within the Consolidated General Fund.⁷

⁴ I have reduced the planned May disbursement by \$1 million from the originally proposed amount of \$5,605,745 for reasons discussed in Section D of this report.

⁵ The State Bar's Chief Operating Officer Leah Wilson provides a more comprehensive explanation of all the pertinent aspects of the 2017 State Bar budget in the final version submitted to the Legislature in February 2017. Electronic copies are available for the Court's review.

⁶ It is important to keep in mind that the P-2 programs funded by the Court-ordered special assessment do not represent the full extent of the State Bar's attorney discipline system. The Client Security Fund (CSF) and Legal Assistance Program (LAP), each of which have dedicated funding sources, should also be understood as constituting discipline-related activities of the State Bar. In fact, in developing a workforce plan for the State Bar's discipline system, NCSC specifically included LAP and CSF within the scope of the State Bar's discipline system and made several recommendations to improve program functioning.

⁷ The cost of the P-2 programs will be approximately 41 percent of the State Bar's total budget this year. All bar spending is generated by three fund types: (1) the Consolidated General Fund; (2) Restricted Funds; and (3) Special Revenue Funds. The Consolidated General Fund consists of nine sub-funds, the largest of which is the Unconsolidated General Fund (UGF). The licensing fees paid by members of the State Bar, including the Court's assessment this year, provide the primary source of funding for the UGF. The UGF, in turn, finances the entire discipline system (except for CSF and LAP, which are supported through separate Restricted Funds) and a majority of the administrative functions that support the system. The proposed expenditures from the Consolidated General Fund for 2017 will total \$81.3 million. Thus, the P-2 programs will account for 83.65 percent of all Consolidated General Fund spending this year.

Most of this additional spending this year is attributable to one-time costs: (1) a \$1.6 million transfer from the Consolidated General Fund to LAP to reverse a \$1.6 million transfer in 2016 from LAP to CSF, which had been made to financially shore up the latter; (2) \$2.2 million to fund employee separation payments for a reduction in force program; (3) \$1.7 million in pre-planned capital improvements for the San Francisco Howard Street building to maintain basic infrastructure integrity; and (4) a \$2.5 million investment in updating the disciplinary case management system (CMS), which I discuss in further detail later. The State Bar must also fund an additional \$5.3 million in “step” salary increases for bargaining unit employees who have not reached the top of their salary range. Lastly, the State Bar will use approximately \$2.6 million in reserves to finance the non-disciplinary public protection programs that were not funded by the Court’s assessment: (1) the Commission on Judicial Nominees Evaluation (JNE) at \$658,592; (2) the Center on Access to Justice at \$1,711,304; (3) the Access to Justice Commission at \$20,320; and (4) the unfunded portion of the Office of Communications’ budget at \$254,000. The portion of CYLA relating to its associational activities that were not included within the scope of the Court’s assessment (86.5 percent) will remain unfunded for 2017. The State Bar reports that the overall impact of this use of reserves should leave all fund balances above the Board-mandated minimum reserve floor of 17 percent at the end of 2017. At the same time, it should be understood that this entails the use of a one-time safety net. Use of reserves may not be a future option if the State Bar is not fully funded in 2018.

D. Summary of P-2 program expenses

Total expenses of the P-2 programs funded by the Court-ordered assessment for the first three months of the 2017 were \$15,007,442, which is \$1,068,087 *below* the budgeted forecast. The bulk of this difference was due to lower than expected personnel costs in OCTC (-\$823,258), which in turn was attributable to a slower than expected hiring process for the several new and open Supervising Attorney positions. (See update on implementation of workforce plan recommendations in the next section.) Several of these positions were filled in March and the hiring process for several more will likely be completed in the coming months, closing the gap between the monthly budget and actual figures. Nevertheless, given the surplus in fund disbursements, I have reduced the May monthly disbursement from the Special Master’s Fund by \$1 million to \$4,605,745 to account for this initial but substantial budgetary deviation.

Six of remaining nine P-2 programs (MFA, OPC, MRC, OGC, OC, and MB) were all less than 10 percent *under* budget for the first three months of the year, while three — SBC, Probation, and CYLA — were *over* budget. SBC was \$125,585 *over* budget at the end of March, mostly due to higher than expected salary and benefits costs in the hearing department. Similarly, Probation had higher than expected salary expenses in March, leaving the department \$46,148 *over* budget for the first quarter. The reason for these variances appears to be related to the CMS project, which launched on February 8, 2017, approximately midway through the first quarter. As part of the CMS project design,

subject matter experts (SMEs) from each affected disciplinary department were identified to assist with the configuration and implementation of the system. Thus, the salary and benefit expenses related to the time that these SMEs spend on the project are budgeted for payment through the CMS cost center (i.e., a non-P-2-related cost center). However, because the project launched later than anticipated and the SMEs' involvement is limited in the early stages of the project, they spent a larger percentage of their time than anticipated in the first quarter working in their home cost centers (i.e., Probation, SBC, and OCTC), even though their salaries and related benefits continued to be paid through the CMS cost center throughout the first three months of the year. Thus, at the end of the quarter, the CMS project manager provided time records for these employees to Finance, which prepared adjustment journal entries to more accurately track these personnel expenses back to Probation, SBC, and OCTC. This in turn caused the former two departments' first quarter expenses to rise above expected levels.⁸ Based on my investigation, I have not directed the Finance adjust the budgets for these two departments to account for these variances. The early stages of the CMS project involve a review of business processes, infrastructure, and network security – all of which requires little involvement by the SMEs. However, the next stages of implementation from May through August will require intensive staff involvement. Thus, I expect second and third quarter cost adjustments may negate the effect of these first quarter chargebacks to Probation and SBC cost centers. I will continue to monitor this situation closely.

CYLA's year-to-date expenses were \$5,637 higher than anticipated as of March 31, 2017. The reason offered for this variance is that CYLA's total 2017 budget of \$25,192 is largely earmarked to fund three continuing education events over the course of the year, two of which were completed in the first quarter of 2017. Thus, the department only appears to be over budget because the total budget for the program was spread over 12 months using a straight-line method when in fact approximately two-thirds of the anticipated annual expenses were front-loaded into the first quarter. I expect, therefore, the expenses will align with budget by the end of the second or third quarter of this year.

Finally, given that expenses under the Board of Trustees' cost center are treated as overhead costs which must be borne in part by the discipline system, it is worth noting that the catering costs for Board meetings totaled \$61,464 in the first quarter of 2017, far exceeding the annual budget for this category by over 100 percent. According to staff, the bulk of this expense is related to the Board's planning meeting in January at the San Diego Sheraton Hotel. While the State Bar changed its travel and catering policies prior to this meeting to restrict such expenses, it was unable to cancel the contract with the Sheraton without incurring substantial cancellation fees and penalties. The total budget for the Board of Trustees' cost center for 2017 is \$211,700, and actual expenses as of March 31, 2017 were approximately half that amount, \$106,265. The State Bar's

⁸ OCTC's expenditures did not similarly exceed budget because of the offsetting effect of slower than expected hiring, as discussed earlier.

Finance department contends that Board expenses will slow considerably in the coming months as the Board confines all future meetings to State Bar facilities and that the department should ultimately remain under budget for the year. I will continue to closely track these expenses as well.

E. Update on implementation of workforce plan recommendations and the case management system

On May 13, 2016, the State Bar submitted a Workforce Planning Report (Report) to the Legislature as mandated by Business and Professions Code section 6140.16. The Report, which was produced by consultants from NCSC, contained 77 recommendations for changes to the organization and workflow of six State Bar discipline-related departments: (1) OCTC; (2) SBC; (3) Probation; (4) LAP; (5) CSF; and (6) MRC. As of December 31, 2016, 58 of these recommendations (75 percent) were implemented fully or in part. Of the remaining 19 recommendations designated as pending or on hold at the end of 2016, 13 pertained to OCTC. The special regulatory assessment ordered by this Court on November 17, 2016, specifically included a \$9 per active member fee intended to augment efforts within OCTC to implement these 13 pending recommendations. Thus, I provide a brief summary of those efforts as part of this report.

NCSC's workforce plan recommendations for OCTC largely focused on eliminating excessive specialization and over-centralization of decisionmaking authority through a fundamental transformation of the department into a flatter hierarchy of multi-purpose, cross-disciplinary teams. A critical component of this reorganization is the creation of new Supervising Attorney positions with the authority and responsibility to perform full-scope supervision of the teams. However, OCTC staff who are classified as Supervising Senior Trial Counsel historically have not performed full-scope supervision in the manner contemplated by the recommendations. Therefore, the State Bar in July 2016 began negotiating the establishment of this new position with Service Employees International Union (SEIU), which represents State Bar bargaining unit employees. The parties reached a resolution in January 2017, clearing the way for the recruitment and hiring process to begin. As of the beginning of April 2017, OCTC hired 14 new Supervising Attorneys and completed its first comprehensive training for supervisors and managers on April 5-7, 2017. OCTC began the process of realigning staff into teams organized under these Supervising Attorneys on April 24, 2017.

Since the start of the year, the State Bar has taken several additional steps to implement the workforce planning recommendations. The State Bar has created a new Training and Calibration Unit within OCTC with a mission of ensuring that decentralization of the office will not result in unintended inconsistencies in charging practices, levels of discipline, or stipulated resolutions of cases. In February 2017, the State Bar hired a new Senior Training Attorney and currently is recruiting an Assistant Chief Trial Counsel for Calibration to head up the new unit. In sum, the hiring of new

Supervising Attorneys and realignment of staff will now allow the State Bar to fully implement nine of the remaining 13 NCSC recommendations related to OCTC.⁹

The last four recommendations are contingent upon completion of the long-overdue upgrade of the State Bar's Case Management System (CMS).¹⁰ The Court's special regulatory assessment did not include funding for the CMS project in 2017 because it appeared the project had sufficient financial support for the coming year. Nevertheless, because four workforce plan recommendations are dependent upon completion of this project and the CMS represents a critical component of the attorney discipline system, I provide the following brief update on the progress of this initiative.

As I indicated in my November 9, 2016, report to the Court, the Board approved a contract with Tyler Technologies, Inc. for procurement and implementation of a new CMS on July 21, 2016. The State Bar executed the contract with Tyler Technologies on December 16, 2016. On February 8, 2017, an official kick-off meeting was held with the State Bar executive team, department managers, IT team, and Tyler's technology team. The State Bar also included subject matter experts (SMEs) from each affected department who are considered to be extremely familiar with their department's processes and procedures. The SMEs will remain heavily involved in the configuration and validation of the CMS throughout the design and deployment process. The State Bar is currently working closely with Tyler's project management team to finalize the project charter and timeline. The target date for completion of the new CMS is March 31, 2018. The total cost for the project is estimated to be \$5,619,800. The State Bar projects 2017 spending on the initiative to be \$4.966 million – \$2.5 million for system procurement and licensing

⁹ These recommendations include: (1) creation of teams comprised of attorneys, investigators, paralegals, and clerical support staff overseen by Supervising Attorneys; (2) elimination of separate intake and enforcement units, and creation of intake and enforcement teams to which staff are assigned on a rotational basis; (3) empowerment of Supervising Attorneys to exercise significant discretion in charging, case management, and disposition decisionmaking; (4) reassigning clerical staff from Central Administration to support teams; (5) process changes to case file creation and management; (6) changes to case assignment processes for intake evaluation; (7) changes to case assignment processes for investigation and complex case designation; (8) elimination of most specialization groups and replacement with general enforcement team structure; and (9) creation of a specialized team to handle cases involving appeals or regarding the unauthorized practice of law by non-attorneys.

¹⁰ These four recommendations include: (1) moving to a single file number system for complaints and cases (OCTC and SBC currently have separate numbering systems); (2) establishing a secure online portal for complaint filing and upload of supporting documents to allow for secure communications between OCTC and case participants; (3) use of approved electronic signatures for case documents; and (4) establishing point-of-action data entry.


and \$2.466 million for technology infrastructure and deployment costs including project manager staffing. Total financing for the project will be derived from the Technology Fund (\$2 million), the IT Special Assessment Fund (\$1.22 million), Fund 88 transfer (\$600,000), savings from credit card fee charges instituted this year (\$800,000), with the remainder drawn from the UGF reserves (\$1 million).

CONCLUSION

Consistent with my responsibilities as Special Master, I will continue to monitor the State Bar's compliance with California Rules of Court, rule 9.9 and the Court's order.

Dated: April 28, 2017

Respectfully submitted,



Elwood Lui