

ALTERNATIVES TO RETRENCHMENT



ALTERNATIVE FUNDING:

AN OVERVIEW

by

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## I. INTRODUCTION

This year, 102 LSC recipients are receiving funds from private sources, including foundations, corporations, individual donors, bar associations, United Ways and other miscellaneous sources. In addition, 93 LSC recipients are receiving funds from state and local government sources, such as general appropriations from the state legislature, contracts with local agencies to provide specific services (e.g. representation of institutionalized persons), and filing fees. Two states, Florida and California, now appear close to adoption and implementation of client trust fund plans. While even rough estimates cannot be made as to the amount of income expected to be generated through such plans, California reportedly expects to receive anywhere from \$500,000 to \$10 million annually, with the bulk going to legal service staff programs and support centers.

This paper is intended to provide the reader with an overview of alternative funding sources and the experiences of programs that have been successful or unsuccessful in obtaining private sector and local government funds. Part I, an introductory section, covers LSC experiences and basic groundrules for fund-raisers. Part II, "WHO DOES IT?", explores the role of staff and boards in fund-raising and the option of hiring outside fund-raising firms. Part III summarizes training programs, libraries and resource materials. Part IV reviews foundation and corporation sources, and gives hints for grantseekers. Part V covers grassroots fund-raising and discusses pros and cons of joining United Ways. Part VI discusses funding from bar associations, Part VII discusses state and local funding (including filing fees), and Part VIII reviews recent developments in client trust fund plans.

Information for this paper was gathered through interviews with legal service program directors, LSC regional office staff, private sector fund-raising consultants and other persons having experience with private sector fund-raising. My special thanks go to Ann Swanson and Rhonda Miller of the National Legal Aid and Defender Association, who shared their extensive expertise and provided me with helpful resource materials for this paper.

Because private sector fund-raising is an area that is relatively new to LSC recipients, there has been no concerted effort made in the past to collect and organize information on the experiences of individual programs. Because of time constraints, I havenot been able to contact every program director who has experience in this area, and who may be able to offer information on training programs and resources. Therefore, this paper should be treated as a starting point for discussion and examination of alternative funding for legal service programs.

If you have additional information that is not covered in this paper, please contact the author or the OFS Delivery Research Unit and share that information with us so that it can be made available to others. Also, if you have attended any training events on fund-raising, please let us know whether you found the events helpful and whether you would recommend attendance to other program staff. In these ways, we can build upon each other's experiences and share information as quickly as possible in this rapidly changing area. Comments can be directed to:

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Magnitude of Private Funding

OFS statistics on alternative funding show that with few exceptions, private sector and local government funding account for relatively small percentages of program budgets:

Private Source Funds are being received by 102 LSC recipients this year. Among these programs, 86.3% receive sums that account for 10% or less of their total budgets. In fact, a majority of the programs (61.8%) receive sums that account for 5% or less of their budgets.

More than half of the programs receiving private source funds look to United Ways as their major contributors. Only 11 programs reported foundation grants this year. Of these, nearly all received amounts that accounted for less than 10% of their total budgets. The average foundation grant, when received, was approximately 3.88% of total budget.

State and Local Funds also tend to account for small percentages of total budgets. Of the 38 programs receiving state funds this year, 73.7% received sums that accounted for 5% or less of their budgets. Of the 55 programs receiving local funds, 69.1% received sums that accounted for 5% or less of their budgets.

While these statistics may appear discouraging, the underlying dollar amounts obtainable from private sector and local government sources can be significant. Therefore, program directors who have been successful in alternative fund-raising feel that it is certainly worth the effort. However, they caution prospective fund-raisers to be prepared for a task that will be time-consuming and long-range in nature.

Some Groundrules

Basic groundrules that are worthy of consideration before you embark on a fund-raising campaign are the following:

1. Fund-raising is a time-consuming process with no guarantees of success. Experienced program directors repeatedly warned that successful fund-raising campaigns require substantial amounts of staff time and energy. One program director described his role as that of a "money hustler" --- in establishing and maintaining 13 separate funding sources for his program, he spends much of his time cultivating ties

with key members of the foundation, corporate and bar communities. Although other staff may assist in the fund-raising endeavor, the task requires the attention and involvement of the program director. Board involvement can also be critical to successful fund-raising. This is because of two principles of corporate and foundation solicitation: "peer solicits peer" and "foundations fund people, not projects." The "peer solicits peer" principle means that when a corporate or foundation executive is approached, (s)he expects to be approached by a similarly high level executive or representative of the grantseeking organization. The "foundations fund people, not projects" principle means that grantseekers rarely receive funds unless the donor has confidence in the leadership of the organization, and this requires personal contacts and relationships with that leadership, including both the program director and key members of the board. (These principles are described further in Part II.)

There are no guarantees of success, although there are ways of improving your odds. Of the one million plus requests made to private foundations, only 6 to 7% succeed in receiving support.<sup>1</sup> This low success rate is due primarily to the failure of grantseekers to match their proposals with the interests of the foundations. The second reason most frequently given for rejecting proposals is that they are "inferior" in quality. In other words, the grantseekers have failed to do their "homework."\* Doing your homework is essential to successful fundraising, but it does involve significant commitments of time: researching foundations and corporations so that you can select only those that are interested in

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<sup>1</sup>NLADA FUNDING NEWS, July 1981 issue, page 1.

\* At a MEET THE FUNDERS conference sponsored by the Boston Regional Office last July, foundation and corporate executives stressed to legal service program directors that they must do their "homework" if they wish to have their proposals taken seriously by grantmakers.

your field; preparing well-documented and persuasively written proposals; establishing contacts with potential donors; developing a helpful program board and making certain that key board members are willing and able to assist in approaching potential donors; and gaining the support and endorsement of bar leaders, state/county officials, community leaders and other key figures.

2. Expect a substantial time lag between your application for funding and receipt of funds. Obtaining corporate or foundation dollars can take anywhere from six months to a year or more. Some foundations may reject your proposal one year but be willing to reconsider it during the next fiscal period. Getting into United Ways can take several months to a year or more, depending on review processes and interests of your local affiliate agency. Grassroots fund-raising, such as direct mail, telephone campaigns, and events-oriented appeals, are always long-range efforts. You can expect to operate at a loss or barely break even for the first year or two of a major grassroots campaign. On the other hand, once established, grassroots funding can be a stable funding base.

Florida and California have been working on client trust fund plans for the past 3-5 years, and only now does it appear that such plans will be implemented during the coming year. Although their groundwork will make it much easier for other states to follow with similar client trust fund plans, such major efforts should be viewed as part of a long-range fund-raising plan. Despite the waiting and planning periods involved, the results can be fruitful and programs interested in alternative funding should begin the process now.<sup>1</sup>

3. Be open to different funding sources and a mixing of funding packages. Unless prior experiences are vastly distorted, legal service programs should not expect any single funding source to make up

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<sup>1</sup>An article describing the efforts behind the Florida plan is being prepared for the next NLADA BRIEFCASE issue. See also Part VIII of this paper.

for losses caused by LSC cutbacks and inflation. Therefore, you should examine all possibilities -- private foundations and corporations, bar associations, grassroots fund-raising, filing fee add-ons, client trust fund plans, state appropriations and any other potential source. Don't overlook the possibility of church organizations -- start with local ministers and ask if there is a local council of churches, or a regional council, or a national body which makes grants.

Consider leveraging your dollars: approach several potential donors and explain that a total funding package is possible if each contributes a share. Having the combined support of like-minded donors adds legitimacy to your efforts and provides an opportunity for donors to participate in a larger, more prestigious scheme than their single contributions might permit. An urban legal service program, for example, received \$5,000 each from five local foundations in order to make the down payment on their building.

4. Examine carefully the disadvantages that might be associated with accepting a grant and managing a multi-source funded program.

Unrestricted funds are rarely given, and programs should carefully consider whether any funding restrictions or burdens are outweighed by the benefits of receiving those additional dollars. The October 1980 issue of CLEARINGHOUSE REVIEW contains an article on "Managing Non-LSC Funding," written by John Landis, Director of Community Legal Aid Society, Inc., Delaware. Mr. Landis provides a very helpful perspective on the management issues associated with non-LSC funding. Among the issues discussed in that article are:

- Inconsistency with program mission

Will the funds require that your program engage in a project which is inconsistent with overall mission and priorities?

What are the possible problems if that occurs, such as staff dissent, communication problems and conflicting messages being sent to the public about

- Damage to relationships with client groups

By applying for funds, will you be placing yourself in direct competition with a client or community group?  
Is a joint application desirable?

- Staffing problems

Since alternative funding may be short-term, will it create staff morale problems?

If a new project is required, how will staff training be handled?

How will staff supervision be handled, and are such costs covered by the grant?

- Reporting requirements

How onerous are the financial, statistical and narrative reporting requirements? Are these costs included in the grant?

Is there a danger that the donor will seek information intruding on the confidentiality of the attorney-client relationship?

As a general rule, there are fewer restrictions and reporting requirements on foundation and corporate grants as compared to government funding. Also, as an experienced program director pointed out, legal service programs may obtain a waiver of a donor's particular financial/auditing requirements by demonstrating that the program has a well-established system that would be disrupted by attempting to meet the donor's requirements.

5. Look beyond foundations and corporations, and seriously consider such options as grassroots fund-raising, filing fee add-ons, client trust plans, bar association support and state appropriations.

While many think of foundations and corporations as the places to turn to for alternative funding, there are several facts that make these two sources very limited in terms of answering the needs of legal service programs. In 1980, the private giving picture was as follows:

\$	2.5 billion	Corporations/corporate foundations
	2.5 billion	Foundations
	39.9 billion	Individuals
	2.9 billion	Bequests
\$	<u>47.8 billion</u>	

89.7% of all philanthropic giving came from individuals, not from foundations

or corporations. Foundation grants also tend to be short-term, covering a year or two or three at the most in most instances.

There are about 300,000 nonprofit organizations in the country, and the competition for private sector funds is becoming increasingly intense. Foundations and corporations are experiencing unprecedented increases in the number of requests for grants being submitted to them. Although no firm statistic has been published, foundations reportedly are seeing a doubling of proposals since the beginning of the year.

President Reagan has suggested that a large part of losses caused by cutbacks in federal funding would be picked up by private philanthropy. However, a look at the history and pattern of private giving, and the impact of the changes in our tax laws, raises questions about such a possibility. A recent study conducted by the Urban Institute estimates that there will be losses of \$27 billion in government funding over the next five years for nonprofit organizations in the areas of social welfare, health, environment, arts, housing and food programs.<sup>2</sup> The Urban Institute study concludes that private giving from all sources (for non-religious purposes) would have to increase 144% over the next five years in order to make up for these anticipated losses in public funds. This is four times the actual rate of growth in private giving over the past five years, a possibility that seems remote even under the best of circumstances.

The 1981 amendments to the tax laws actually will have the effect of discouraging private giving. As previously shown, 89.7% of all private giving comes from individuals. The 1981 tax amendments will reduce the ceilings on personal income taxes, giving higher income taxpayers less incentive to make charitable donations. After January 1, 1982, when the top tax rate drops from 70% to 50%, gifts to charity will be

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<sup>2</sup>THE FEDERAL GOVERNMENT AND THE NON-PROFIT SECTOR: IMPLICATIONS OF THE REAGAN BUDGET PROPOSALS by Lester Salamon with Alan Abramson (The Urban Institute, 2100 M Street, N.W. Washington, D.C. 20036)

worth correspondingly less to taxpayers who had been paying rates over 50%. Also, by raising the ceiling on the value of estates subject to federal inheritance taxes (eliminating the inheritance tax for all estates under \$600,000), the new tax laws will provide less incentive for estate giving.

Ironically, the push for increased giving is being made the lower end of the income scale. Taxpayers who file unitemized returns ( primarily wage earners and less affluent persons) will be allowed to take additional deductions for charitable giving. In addition to their standard deductions, such taxpayers will be allowed in 1982 to deduct 25% of donations up to \$100, and the amounts will rise to 25% of any donations in 1984, 50% of any donations in 1985, and 100% of any donations in 1986.

The new tax laws are expected to cause significant drops in the level of giving to all charities. According to a recent study by the Urban Institute, done for the Independent Sector (a coalition of 320 leading foundations, corporations and nonprofit organizations) on the impact of the new laws, contributions from individuals to universities, museums, hospitals, antipoverty and religious groups are projected to drop at least \$18 billion during the next four years as a result of the amendments. Lester Salamon, political economist for the Urban Institute, said that the \$18 billion estimate is probably understated because it does not consider the possible effects from the tax law amendments on estates, foundations or corporations.

II. WHO DOES IT?

A. Staff and Board Involvement

A number of programs are looking into the possibility of hiring new staff or private fund-raising firms to handle their fund-raising campaigns. While new staff or outside firms may be able to do a significant amount of the fund-raising work, the advice given by experienced program directors and private fund-raisers alike is that in any successful campaign, the involvement of the program leadership, including the board, will be unavoidable. There are several reasons why this task cannot be easily delegated to others.

Some alternative funding sources such as client trust fund plans and filing fee add-ons will be looked upon with skepticism and/or hostility by bar leaders, state legislators, county officials and the like. Such options will require that the program engage in a concerted campaign at the local and state level, and that the work of different legal services programs within a state be coordinated. In that process, the role of the program leadership will be critical.

Also, as mentioned previously (page 4), the principles of "peer solicits peer" and "foundations fund people, not projects" apply. Staff members and outside consultants may be able to do the grants research, write the proposals and make the initial phone calls, but the program leadership will have to be involved at critical points throughout the solicitation process. While "who you know" isn't everything, it is very important, especially in the foundation and corporate worlds. The decision-makers in private foundations and corporations exercise broad discretion in making grant decisions. A great deal depends on who is associated with your program, and who gives it respectability and legitimacy in the eyes of

the decision-makers.

One program director who has obtained corporate and foundation grant finds that one rarely gets a grant unless s(he) has established a relationship with an "inside person". He said that generally communications begins with a middle-level person (such as a "program officer"), who can provide helpful information about the grant application and review process and the names of persons who will be involved in examining your proposal.\* The program director then begins to identify links between his board of directors and other supporters and the persons within the foundation. During the final stage of the grant application process, a higher level person will enter the picture, perhaps a vice-president or other officer. That higher level official is the person who will be making a presentation about the proposal to the foundation's board or grants committee, so his/her support is critical. At that point, the program director has pulled in his board members or other key supporters, who may attend a meeting with the foundation executives or make phone calls on behalf of the program.

The role of the legal service program board can be instrumental in obtaining alternative funding, and many program directors rely on their boards to assist in the fund-raising process. For example, one program has a 58-member board, and the director attributes much of his success in fund-raising to the composition and involvement of the board. The board size is large but manageable, because there is a core group serving on an executive committee that works with the director. Board members are chosen to serve on the board because they are well-connected to the business, political, financial and client communities. The

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\*Not all foundations have paid staff. Although most large foundations do have staff, many smaller foundations may operate with volunteers and through board meetings.

board includes, for example, the corporate counsel of a major corporation that has donated funds to the program for a number of years. Other board members have intervened on behalf of the program when political problems have arisen, or when funding sources were wavering in their support. Last year, for example, the local United Way instituted a system of prioritized giving. The legal service program was given a #6 rating by United Way, which meant that it would not receive an increase in funding and may, in fact, be cut. A board member intervened through his connections with United Way, and the program rating was changed to #2.

A simple way of determining whether board members have contacts with potential funding sources is to distribute a list of potential donors at board meetings.

Because of board composition and selection requirements imposed by the Act and regulations, it may be very difficult for legal service programs to build helpful boards (from the fund-raising perspective). Presently, 60% of all members must be attorneys and one-third must be client representatives. Unless you have a very large board, this means that all but a handful of "other" lay persons are excluded -- such as business and foundation executives and other influential lay persons. One way of dealing with this situation is to try to get as many well-connected attorney and client representatives as possible: corporate counsel, bar association leadership, spouses of foundation executives, and client representatives who may have ties with community foundations, church groups, and other community-based organizations that could assist in grantseeking and grassroots fund-raising.

Another alternative is to set up a separate advisory board for fund-raising support. Many programs already have advisory boards that were created in order to expand the opportunity for client input.

That same principle could be applied to create advisory boards to expand the opportunity for alternative funding.

Should you hire someone to devote most or all of his/her time to fund-raising? Several programs have administrative assistants or other personnel who are responsible for much of the fund-raising work. I was able to locate only one program that had hired someone to do fund-raising on a full-time basis.\* That program, which serves eight, predominantly rural counties in the northeast, had a budget of about \$800,000 last year. About a year and a half ago, as static funding loomed ahead, the program director began to explore alternative funding. He tried sending letter proposals to foundations, using the shotgun approach to a large extent, and found that "wish lists get you nowhere." After concluding that the program might benefit from having someone who could concentrate on identifying and cultivating a few good prospects, the program hired a grant writer at a salary of \$22,000. The person hired was a former local CAP administrator who knew about the work of the legal service program. More importantly, the grant writer was familiar with the government bureaucracy and its processes. In just over a year, he was able to raise \$140,000 in federal and state grants that otherwise would not have come to the program.

Although there are fewer federal and state grants available these days, the strategy used by the grant writer and program is instructional. The grant writer began by studying the Federal Register for agency listings of available grants, and by making similar inquiries at the state and local level. He spoke to the agency officials, and found out what they were interested in doing with the grant funds, and the purposes for which such funds could be used. He then focussed on a few possibilities that involved low income housing (availability and quality of such housing), which was

\*If you have a full-time development person, please share your experiences with us

an area of program priority. In that way, the intent of the government agency coincided with the needs of the community and the priorities of the program. Nearly a year was spent doing client and community education activities. The grant writer and staff worked towards developing and organizing a community base that would be strong enough to demonstrate to the federal and state agencies that their proposal was supported by the community at large. Endorsements were solicited from clients, community organizations, churches, local officials and others. Although the program was not making a joint application with any community group, this field work was essential in order to demonstrate to the government agencies that the necessary links with the community had been established. A total of about \$140,000 was raised, including \$42,000 from a federal agency and \$84,000 from a state agency. These grants will be used to develop a program which will involve staff services and citizen monitoring to ensure that grants and loans are made available for new housing and renovation of existing housing.

The grant writer left the program recently, and the program decided that it would be worthwhile to continue the position. In seeking a replacement, the director looked for the following characteristics or qualifications as key to effective fund-raising:

1. Someone who is experienced in fund-raising and who can translate that experience to the program's local situation, regardless of whether that experience was derived from working in that area or elsewhere.

AND/OR

2. Someone who can think and write effectively and who is plugged into the local situation -- who know the local agencies, bureaucrats and political processes.

B. Should You Hire a Private Fund-Raising Firm?

There are a large number of private firms and consultants who offer a wide range of services at an equally wide range of fees. Because each firm offers so many different packages and because I found such wide variations in fees, it is difficult to give even "ball park estimates" of what you might encounter among the firms you contact.\*

Services available through private firms include training, grant research, proposal writing, direct mail and other grassroots solicitations, feasibility studies, capital campaigns, general campaigns, planning consultations, and just about any combination of the above, as well as a few other services.

A few legal service programs have already contracted with private fund-raisers. One large urban program, for example, is paying a firm \$2,200 to plan and begin a fund-raising campaign. The fee covers 16 days over a period of 6-8 weeks. Another program is exploring the possibility of a contingency fee arrangement with a firm.

Because I was unable to locate any legal service program that has had any significant experience with a private fund-raising firm, I

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\*Anyone interested in contracting for the services of a private fund-raising firm should try to learn as much as possible beforehand about fund-raising and alternatives. (See information in Part III on training programs and resource materials.) If possible, invest a day or two in attending a workshop or seminar on grantsmanship/fund-raising so that you can assess for yourself whether all or part or none of the work could be handled by your program in-house. Is it true, as one such firm warned me, that there is "no way you can do it without professional counsel?" If you decide that you need professional assistance, having personal knowledge of the basics of fund-raising will help you decide specifically what kinds of services you need and how much those services are worth to you. Finally, remember that private firms work in the traditional areas of government grants and foundation and corporate grants, or some specialize in direct-mail and grassroots fundraising. They will not be able to assist you in trying to establish a client trust fund plan or in obtaining filing fee add-ons, or some of the other more innovative options available to legal service programs.

am able to share only the information that some firms were able to give me about themselves.\* Also, some basic advice about shopping for a firm was provided to me by the American Association of Fund-Raising Counsel, Inc. (AAFRC), which is an association of about 30 counseling firms located throughout the country.\*\* Member firms deal exclusively or primarily in the areas of fund-raising counseling services, feasibility studies, campaign management and related public relations. The association requires that member firms be headed by someone with at least six years of continuous experience in the fund-raising field, and that member firms subscribe to a "Fair Practice Code", including the following:

2. While the Association does not prescribe any particular method of calculating fees for its members, the Organization should base its fees on services provided and avoid contracts providing for contingency, commissions or a percentage of funds raised for the client...Member firms will not offer or provide the services of professional solicitors.

Contingency fee or percentage arrangements are frowned upon for basically the same reasons that some attorneys frown upon such practices in the legal profession. Such arrangements can result in overcompensation, and may cause additional problems if there is not a clear understanding of the treatment of pledges vs. unfulfilled pledges vs. monies actually collected.

Generally, initial consultations between a prospective client and a private fund-raising firm are not billable services. Most firms will give you a written proposal or description of the services offered to your program and the fees. AAFRC advises that you check with at least

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\*If you have had experience with private fund-raising firms, please share your experiences with the Delivery Research Unit at OFS.

\*\*A directory of AAFRC member firms is available (free) by calling or writing the American Association of Fund-Raising Counsel, Inc., 25 West 43rd Street, New York, New York 10036, (212) 354-5799.

two or three firms before selecting a firm. Since AAFRC members are purportedly the top firms in the country, you may find their fees to be higher than those of other firms.

One of the best ways to learn about the track record of a fund-raising firm is to talk to former clients. Many firms will provide prospective clients with a list of former clients and information on campaign results. When possible, examine experiences that relate to organizations similar to your own, i.e., advocacy groups, community-based organizations vs. hospitals, colleges, museums.

Basic areas of inquiry when looking for a private fund-raising firm are as follows:

1. Does this firm have experience with legal service, public interest, social service, civic or public affairs organizations? You probably will not find a firm with significant experience on behalf of legal service programs. However, you might find a firm which has worked with community-based groups and advocacy programs such as mental health agencies, settlement houses, emergency shelters, etc. While such experience is not essential, it will provide you with information on the firm's track record in aiding organizations similar to your program.

Try to avoid firms that have dealt exclusively with one type of client, such as hospitals or colleges because they may have limited expertise.

2. Ask the firm about prior clients and fund-raising experiences, and talk to some former clients.
3. Geographical location generally is not an important consideration, because fund-raising techniques can be translated from one locality to another. However, the distance between a firm's office and your locality will result in additional expenses payable by your program (travel, lodging, toll calls). Communication problems (and reductions in the amount of communication) and oversight and responsiveness problems may also arise because of distances, making proximity a desirable feature when possible.
4. What services does the firm offer, and on what terms?  
-Will services be provided on a flat fee basis, or on a

contingency or commission basis?

- Who will actually work on your account? Is there an account executive assigned to your account, and how available will that person be? How many other accounts does that person carry? Does it appear likely that much of the work will be done by an assistant and if so, what are the skills and supervision? (Some firms limit the number of accounts per account executive, e.g., 3 per account executive, and therefore may have to charge higher fees for the time set aside per account.)
- What provisions are there for cancellation or termination of the contract? AAFRC firms generally recommend a 30-day cancellation clause in each contract. Where the firm is paid on an hourly, weekly or monthly basis, the amounts owed can be quickly calculated for terminating the contract. If other payment arrangements have been agreed upon, what provisions are there for cancellation and final payment?
- Will the firm help train your staff and build your inhouse capacity for future fund-raising activities? Many packages are available for a combination of training and follow-up counseling.

The following fees are quoted for the sole purpose of giving you an indication of some of the fees charged by a few firms (you will no doubt find that other firms will quote fees that are higher, lower or similar to these, and this is by no means a scientific sampling):

Grant Research Services: \$495 to \$1395, depending on the number of resources you wish to have identified. You may ask for 10, 20 or 30 sources -- for example, 10 foundations and 10 federal sources, etc. The firm will research the sources and make recommendations as to specific foundations, corporations and/or government sources that have grant programs and interests in your type of work.

Proposal Writing: \$2,000 to \$10,000, depending on complexity. Firms may also charge by the hour, and the hourly rate will depend on who works on your proposal. Ranges vary, e.g. \$35 to \$200 per hour.

Feasibility Studies: A feasibility study is an analysis of your program's strengths and weaknesses, organizational leadership, and ability to raise funds. It involves a large number of interviews (15-75 people, 2 weeks to a month) with program staff, board members, representatives of the community, and potential funders. The firm prepares an extensive report as a result of those interviews, and draws conclusions and recommendations as to future fund-raising efforts. Potential funders are approached and asked questions such as "given the fact that X organization does this that and the other, what is the likelihood that your foundation would give money to them?" One firm that offers this service said that interviews with potential funders are confidential, so the names of such potential funders cannot be made available to the organization even after the study has been concluded. Another firm will provide you with a complete listing of funding sources that have expressed interest in your organization.

Fee quoted by first firm was \$9,000, \$4,500 payable up front with the balance due upon delivery of the written report. (Plus expenses)

Fee quoted by second firm was \$15,000-20,000, depending on the amount of time anticipated. (Plus expenses)

Since this can be a very costly item, you should ask the following:

- How much of this do I already know? Can I obtain this information through the use of volunteers or staff?
- Is such a study necessary or desirable?  
Can I afford to wait two or three months before beginning my fund-raising campaign?  
An experienced firm recommends against feasibility studies because of possible negative consequences. They found that approaching foundations with hypothetical questions were a real turn-off to foundation staff.

Fund-Raising Campaigns: These are full-fledged campaigns that can be expected to last six months, one year, two years or more.

One AAFRC firm charges \$9,000 monthly for a full-time "resident director", (who will work full-time in the client's office or at the firm's office on the account) or \$450 per day for a part-time relationship.

Another firm charges \$24,000 to \$26,000 for a one-year campaign, which includes about 30 hours per week combined time of a team of an account executive, administrative assistant and a secretary. Or, you may receive a series of 8 planning and counseling sessions over a year (every six weeks) for \$5,000.

One final word about "counseling" vs. other types of services that might be available from private fund-raising firms. AAFRC member firms offer counseling services, not the services of professional solicitors. They will assist you in the development of a fund-raising campaign, and will work with you in doing the research of potential sources, proposal writings and other groundwork. However, they expect the grant applicant to do the actual solicitation -- meeting with potential donors and making the presentation on behalf of the program. AAFRC warns against persons who offer to do the actual soliciting on behalf of the program.

If you are thinking of hiring professional solicitors, consider carefully how they will present your program to potential funders and whether their image is what you wish to project to funding sources. Unprofessional solicitation can haunt your program later if that kind of a relationship doesn't work out.

## III. TRAINING PROGRAMS AND RESOURCES

The number and frequency of training programs offered by nonprofit and private organizations and counseling firms grows almost daily. Listed below are some of the programs now offered on a nationwide basis, and resource materials that would be helpful to persons wishing to pursue alternative funding. A number of resource materials include bibliographies which list other books, manuals and other publications for follow-up on specific funding sources and strategies.

TRAINING PROGRAMS

THE GRANTSMANSHIP CENTER, 1031 S. Grant Avenue, Los Angeles, CA 90015 (branch office at 719 Eighth Street, S.E., Washington, D.C. 20003), toll free number: (800) 421-9512.

The Grantsmanship Center is a nonprofit organization which offers training programs and resource materials that have been highly recommended by persons from LSC and NLADA. The training programs are based on a workshop approach, with a limit of about 25 persons per program. The two basic programs are described below:

1. Grantsmanship Training

About 66 of these five-day workshops will be offered between September, 1981 and February, 1982 at locations throughout the country. Tuition is \$395 per participant, and some scholarships are available for organizations having budgets of \$125,000 or less. The course covers program planning, proposal writing, research skills for identification of potential funding sources, and basic grantsmanship for government, foundation and corporate funding. Participants should bring proposals to the workshops, if any have been prepared. The staff works with small groups and provides assistance in evaluating proposals and giving individualized attention in skills development.

2. Fundraising Training

This is a new program offered by the Grantsmanship Center, and is also a five-day program. Tuition is same as above. About 30 programs are being offered between September and next February. In addition to corporate and foundation grants, innovative strategies such as group giving are explored.

Additional information about these two programs, including specific dates and locations available, may be obtained by calling the Grantsmanship Center via the toll free number.

All participants receive copies of the GRANTSMANSHIP BOOK and a one year subscription to GRANTSMANSHIP NEWS, a bi-monthly publication on funding news, tips, deadlines and new publications in the field. Participants may also receive free follow-up services, including proposal critique and telephone consultation.

The Grantsmanship Center also offers a "survival package" for \$39.95, which includes the GRANTSMANSHIP BOOK and a one year subscription to GRANTSMANSHIP NEWS. The BOOK is a compilation of reprints from GRANTSMANSHIP NEWS, and includes articles on The Foundation Center publications, how to research foundations, proposal writing, and descriptions and hints on specific funding sources.

\* \* \* \* \*

#### MEET THE FUNDERS

The MEET THE FUNDERS conference was developed jointly by LSC/OPS and the NLADA. The first conference was held in Washington, D.C. last October, and another conference was sponsored by the LSC Boston Regional Office in July. The purpose of the conference is to bring together program personnel and community representatives with representatives of foundations, corporations, religious organizations and other funding sources for a presentation and discussion about funding strategies and policies of givers. The conference format involves inviting representatives from 20-40 funding sources, and asking each to make a brief (15-20 minute) presentation about their giving policies and processes.

The presentation can be very helpful, particularly to programs that have had some experience in fund-raising. Much of the discussion assumes that the audience knows the basics of fund-raising, and now needs some pointers as to why they have succeeded or failed in the past, and how their skills might be refined.

At the recent Boston MEET THE FUNDERS conference, for example, a foundation representative informed the audience about a change in giving policy that had not yet been publicized, and invited proposals that would have the advantage of reaching the foundation before the word of a new giving policy got out to others. A corporate donor warned that proposals with misspellings or grammatical errors, or that addressed the corporate head incorrectly ("Mr." instead of "Dr.") are automatically removed from consideration.

\* \* \* \* \*

THE FUND-RAISING SCHOOL, P.O. Box 3237, San Rafael, CA 94912,  
(415) 457-3520.

The Fund-Raising School is a nonprofit organization that offers 3-day and 5-day workshops covering non-federal sources such as grassroots fundraising, capital campaigns, foundations, corporations. The courses are held at locations throughout the country, normally at a college campus where dormitory facilities are available to keep lodging expenses down.

The 3-day workshop is on "FUNDRAISING FOR LOW BUDGET GROUPS". Tuition is \$270 per participant, and the School tries to keep attendance at 40-45 persons. This workshop is geared specifically to low budget organizations, and does not get involved in applications for large grants.

The 5-day workshop covers all aspects of fund-raising, and up to 55 participants are allowed. Tuition is \$395.

Participants receive a manual (not available to persons who do not attend the workshops), and may call the School's director for telephone consultation. Tuitions may be slightly higher when workshops are held at more expensive locations.

The Fund-Raising School will also design workshops for groups. Fees depend on the complexity of tailor-made workshops, but are around \$3,200 plus expenses.

\* \* \* \* \*

PUBLIC MANAGEMENT INSTITUTE, 333 Hayes Street, San Francisco, CA 94102  
(415) 431-8444.

The Public Management Institute is a private organization that offers training programs and consultation and research services for nonprofit organizations. Many of its programs are offered through colleges and universities as a part of their continuing education programs.

Three upcoming programs include the following:

1. Direct Mail Fundraising. October 5-6 in Boston; November 16-17 in Washington, D.C.; November 23-24 in San Francisco; and December 7-8 in Chicago. Tuition is \$295 per participant, and \$245 for each additional participation from the same organization. Participants will receive a manual entitled DIRECT MAIL FUNDRAISING (available from PMI for \$47.50 to nonparticipants).

Enrollment is being handled by the Division of Continuing Education, University of Detroit, 4001 W. McNichols Road, Detroit, Michigan 48221, (313) 927-1027. A 12-cassette program on direct mail fundraising is available from PMI for \$129 plus \$2.50 postage and handling.

2. How to Get Corporate Grants. October 6 in New York City; October 8 in Chicago; December 7 in Dallas; and December 14 in Denver. Tuition is \$195 per participant and \$95 for each additional participant from the same organization. Participants will receive a manual entitled HOW TO GET CORPORATE GRANTS. Enrollment through the Center for Organization and Management Development, School of Business, San Jose State University, San Jose, CA 95192, (408) 277-3450.
3. Successful Fundraising Techniques. September 10-11 in Chicago; September 14-15 in New York City. Tuition is \$195 per participant and \$165 for each additional participant from the same organization. An introductory course on fundraising. Enrollment through the University of Detroit, see address above.

NATIONAL COMMITTEE FOR RESPONSIVE PHILANTHROPY, 810 18th Street, N.W.,  
Suite 408, Washington, D.C. 20006, (202) 347-5340.

The National Committee for Responsive Philanthropy is sponsoring a conference on workplace solicitation in Washington, D.C. on November 6-8, 1981. Enrollment fee is \$125.

NATIONAL LEGAL AID & DEFENDER ASSOCIATION (NLADA), 1625 K Street, N.W.,  
Washington, D.C. 20006 (202) 452-0620

NLADA is planning a two-day funding strategy conference in Chicago on November 12-13, to be followed on November 14 by a one-day "nuts & bolts" workshop on how to identify, cultivate and solicit funding sources. The two-day strategy conference will include sessions on traditional sources of funding such as foundations, corporations, individuals and United Way; state and local funding sources; attorney fees and related issues; client participation in resource development; and potential private bar sources, such as bar foundations, client interest trust funds, law firm solicitations, and bar associations. Contact Ann Swanson, NLADA Civil Division, at the above address for more information.

There will also be a development seminar during NLADA's annual conference in San Francisco on December 18, which will include: nine principles of fundraising; the process; efficient use of volunteers; preparation of the proposal; raising funds for capital and annual support; gaining corporate and foundation support; and techniques for cultivating and soliciting individual contributions. For more information, contact Joseph L. Sgro, Director of Development at NLADA.

LIBRARIES

Reference collections on foundations, corporations and other fundings sources are available throughout the country under the auspices of The Foundation Center, which is headquartered in New York City at 888 Seventh Avenue, New York, New York 10017, (212) 975-1120. The Foundation Center has four comprehensive libraries at its four locations in New York City, Washington, D.C., Cleveland and San Francisco. In addition, there are cooperating libraries around the country which may be used to research potential sources.

A number of the libraries may offer orientation sessions or services to describe the materials available in their collections and how to use them. Information about libraries may be obtained by calling the toll free number (800) 424-9836.

In addition to books, periodicals, annual reports, press clippings and other resources, the Foundation Center libraries have computer print-outs that can be used to research foundations and corporations that are interested in law schools, civil rights organizations, legal aid societies, etc.

A listing of the Foundation Center offices and cooperating libraries is on the next page. Libraries are available without charge to the public.

LITERATURE

Reference collections of foundations, corporations and other  
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888 Seventh Avenue, New York, New York 10019, (212) 921-1150. The

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# Where To Go for Information on Foundation Funding

## Reference Collections Operated by The Foundation Center

### Main offices

The Foundation Center  
888 Seventh Avenue  
New York, New York 10019  
(212)975-1120

The Foundation Center  
1001 Connecticut Avenue, N.W.  
Washington, D.C. 20036  
(202)331-1400

### Field offices

The Foundation Center  
312 Sutter Street  
San Francisco, California 94108  
(415)397-0902

### Cooperating Collections

#### ALABAMA

Birmingham Public Library  
Auburn University at Mont-  
gomery Library

#### ALASKA

University of Alaska, Anchorage  
Library

#### ARIZONA

Tucson Public Library

#### ARKANSAS

Westark Community College  
Library, Fort Smith  
Little Rock Public Library,  
Reference Department

#### CALIFORNIA

Edward L. Doheny Memorial Li-  
brary, University of Southern  
California, Los Angeles

San Diego Public Library

#### COLORADO

Denver Public Library, Sociology  
Division

#### CONNECTICUT

Hartford Public Library,  
Reference Department

#### DELAWARE

Hugh Morris Library, University  
of Delaware, Newark

#### FLORIDA

Jacksonville Public Library, Busi-  
ness, Science and Industry Dept.  
Miami-Dade Public Library,  
Florida Collection

#### GEORGIA

Atlanta Public Library

#### HAWAII

Thomas Hale Hamilton Library,  
University of Hawaii, Human-  
ities and Social Sciences Divi-  
sion, Honolulu

#### IDAHO

Caldwell Public Library

#### ILLINOIS

• Donors Forum of Chicago,  
Chicago

Sangamon State University Li-  
brary, Springfield

#### INDIANA

Indianapolis-Marion County  
Public Library, Indianapolis

#### IOWA

Public Library of Des Moines

#### KANSAS

Topeka Public Library, Adult  
Services Department

#### KENTUCKY

Louisville Free Public Library

#### LOUISIANA

East Baton Rouge Parish Library,  
Centroplex Library

New Orleans Public Library,  
Business and Science Division

#### MAINE

University of Southern Maine,  
Center for Research and Ad-  
vanced Study, Portland

#### MARYLAND

Enoch Pratt Free Library, Social  
Science and History Dept.  
Baltimore

#### MASSACHUSETTS

• Associated Foundation of  
Greater Boston

Boston Public Library

#### MICHIGAN

Alpena County Library, Alpena  
Henry Ford Centennial Library,  
Dearborn

Purdv Library, Wayne State Uni-  
versity, Detroit

Michigan State University Li-  
braries, Reference Library, East  
Lansing

University of Michigan -- Flint  
UM-F Library, Reference Dept.

Grand Rapids Public Library,  
Sociology and Education Dept.

Michigan Technological Univer-  
sity Library, Houghton

#### MINNESOTA

Minneapolis Public Library, Soci-  
ology Department

#### MISSISSIPPI

Jackson Metropolitan Library

#### MISSOURI

• Clearinghouse for Midcontinent  
Foundations, University of  
Missouri, Kansas City

Kansas City Public Library

• The Danforth Foundation Li-  
brary, St. Louis

Springfield-Greene County Li-  
brary, Springfield

#### MONTANA

Eastern Montana College Library,  
Reference Department, Billings

#### NEBRASKA

W. Dale Clark Library, Social  
Sciences Department, Omaha

#### NEVADA

Clark County Library, Las Vegas  
Washoe County Library, Reno

#### NEW HAMPSHIRE

• The New Hampshire Charitable  
Fund, Concord

#### NEW JERSEY

New Jersey State Library,  
Governmental Reference,  
Trenton

#### NEW MEXICO

New Mexico State Library,  
Santa Fe

#### NEW YORK

New York State Library, Cultural  
Education Center, Humanities  
Section, Albany

Buffalo and Erie County Public  
Library, Buffalo

Levittown Public Library,  
Reference Department

Plattsburgh Public Library,  
Reference Department

Rochester Public Library, Busi-  
ness and Social Sciences Div.

Oranadaga County Public  
Library, Syracuse

#### NORTH CAROLINA

North Carolina State Library,  
Raleigh

• The Winston-Salem Foundation

#### NORTH DAKOTA

The Library, North Dakota State  
University, Fargo

#### OHIO

Public Library of Cincinnati and  
Hamilton County, Cincinnati

#### OKLAHOMA

• Oklahoma City Community  
Foundation

Tulsa City-County Library  
System

#### OREGON

Library Association of Portland  
Education and Documents  
Room

#### PENNSYLVANIA

The Free Library of Philadelphia  
Hillman Library, University of  
Pittsburgh

#### RHODE ISLAND

Providence Public Library,  
Reference Dept.

#### SOUTH CAROLINA

South Carolina State Library,  
Reader Services Department,  
Columbia

#### SOUTH DAKOTA

South Dakota State Library,  
Pierre

#### TENNESSEE

Memphis Public Library

#### TEXAS

• The Hogg Foundation for Men-  
tal Health, University of Texas,  
Austin

Dallas Public Library, History  
and Social Services Division

• El Paso Community Foundation  
Houston Public Library, Biblio-  
graphic & Information Center

• Funding Information Library,  
Minnie Stevens Piper Founda-  
tion, San Antonio

#### UTAH

Salt Lake City Public Library, In-  
formation and Adult Services

#### VERMONT

State of Vermont Department of  
Libraries, Reference Services  
Unit, Montpelier

#### VIRGINIA

Richmond Public Library, Busi-  
ness, Science & Technology  
Department

#### WASHINGTON

Seattle Public Library, Reference  
Department

Spokane Public Library, Ref-  
erence Department

#### WEST VIRGINIA

Kanawha County Public Library,  
Charleston

#### WISCONSIN

Marquette University Memorial  
Library, Milwaukee

#### WYOMING

Laramie County Community Col-  
lege Library, Cheyenne

#### PUERTO RICO

Consumer Education and Service  
Center, Department of Con-  
sumer Affairs, Santurce

#### VIRGIN ISLANDS

College of the Virgin Islands  
Library, St. Thomas

#### MEXICO

Biblioteca Benjamin Franklin  
Mexico City

• Reference collection operated by foundation or area association  
of foundations

RESOURCES

The following publications are published by The Foundation Center:

The Foundation Directory, 8th Edition. The 7th Edition is now out of print, and the 8th Edition will be available in late September. Orders may be placed with the New York office, or you may purchase a copy from any of the four offices of The Foundation Center. \$45 each.

This is the basic handbook on major foundations.

This Directory lists names, addresses, giving policies and trustees of more than 3,000 large foundations in the U.S. The listed foundations expect that grantseekers will consult this Directory for basic information before contacting them.

The National Data Book, 5th Edition. \$45. (The 6th edition will be available in early 1982, probably around January.) This Data Book lists all of the active grant-giving foundations in the U.S., about 22,000 in all. Listings are organized geographically, and include addresses, principal officers, assets, amount of grants made. May be purchased from any of the four offices of the Foundation Center.

Foundation Center Source Book Profiles. This is a looseleaf service that provides up-to-date information on about 1,000 of the largest foundations. Annual subscription is \$200, available through the New York office. Subscribers receive about 80 profiles bi-monthly.

COMSEARCH Print-outs. These computer-generated print-outs show grants given by subject area, and lists may be purchased by subject area. The list on legal programs, for example, is \$12. Other subject listings may be slightly higher or lower.

Note: NLADA has a computer print-out that is from the same data base as the COMSEARCH print-out on legal problems, but is narrowed to grants given to legal service programs only. The NLADA print-out shows 259 grants given to legal service programs by private foundations, corporate foundations and community foundations. To obtain a copy, send \$5 to Ann Swanson or Rhonda Miller at NLADA, 1625 K Street, N.W., 8th Floor, Washington, D.C. 20006.

The Grantseekers Guide: A Directory for Social and Economic Justice Projects, published by the National Network of Grantmakers, 919 N. Michigan Avenue, 5th Floor, Chicago, Illinois 60611. Only prepaid orders will be processed, \$7.50 per copy.

This guide provides complete listings of grantmakers which have been major supporters of community based organizations in areas of social welfare, health, and advocacy. Published in March, 1981.

Includes introductory chapters on proposal writing, management and organization accountability, corporate giving, selected annotated bibliography and listing of fundraising and technical assistance resources.

The National Network of Grantmakers is an association of individuals involved in organized grantmaking, including staff and trustees of foundations, corporations and church-related giving programs. It is not a staffed organization.

Corporate 500: The Directory of Corporate Philanthropy, published by the Public Management Institute, 333 Hayes Street, San Francisco, CA 94102, (415) 431-8444. 836 pages, \$175. Lists the top 500 corporations and corporate foundations. Entries include names, addresses, phone numbers, contact persons, corporate contributions committee members, corporate giving policies, areas of interest, financial profiles and listing of sample grants and recipients.

Directory of Grants for Law and Advocacy, to be published soon by the Public Management Institute, see address above. \$79, will be available in September-October, 1981. Profiles of 150 foundations, corporations, federal government agencies, and community foundations that are interested in legal representation, advocacy for women, disabled persons, minorities, civil rights, community improvement and renewal and other legal programs.

The Grassroots Fundraising Book, by Joan Flanagan for The Youth Project, 1555 Connecticut Avenue, N.W., Washington, D.C. 20009. \$5.75 postpaid. This 219-page book has been described as the best source of information on how to put together a grassroots fundraising campaign. Includes information regarding specific events, and bibliography. (The Youth Project is planning to publish a second edition later this year. This edition was first published in 1977.)

NLADA Funding News. NLADA's newsletter, Funding News, is currently publishing a series of articles on private sector funding sources and will continue to provide updated information on sources that are good prospects for legal service programs.

## IV. FOUNDATIONS AND CORPORATIONS

FOUNDATIONS

There are more than 22,000 active foundations in the United States, but 51% of all grants come from 199 foundations which hold 65% of all foundation assets. There are four different types of foundations, and each is distinct in terms of the source of assets and purposes:\*

1. Independent Foundations usually have assets derived from the gift(s) of an individual or family. They may function under the direction of family members, or they may have an independent, professional staff and board. The FOUNDATION DIRECTORY lists 21,470 independent foundations with total assets of \$28.7 billion. About 70% of the giving is local, with the remainder national and regional. They may have broad or limited areas of interest.
2. Company-Sponsored Foundations derive their assets from a profit-making entity. Whereas the profit-making companies themselves generally give monies for limited purposes (usually related to their business interests), the company-sponsored foundations usually have broader areas of interest. There are 545 such foundations with total assets of \$1.6 billion. 40% of the giving is local, 50% regional.
3. Operating Foundations use the bulk of their funds for their own research, social welfare and other projects as determined by their boards. Of the grants given to outside groups, about 40% are given locally and 60% regionally. There are 42 operating foundations with total assets of \$685,175.
4. Community Foundations are public charities, as distinguished from the prior three types of private foundations. Community foundations are established by bank resolution instead of by wealthy individuals or companies, and their funds are not derived from a single source. To maintain its public charity status, a community foundation must name itself after the community it serves,

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\*The descriptions of the four types of foundations have been excerpted from the May-June, 1981 issue of NLADA FUNDING NEWS, which is publishing a series of articles of private philanthropy. The May-June issue examines community foundations in depth; the July issue examines private foundations; the August issue examines corporate giving; and the September issue focuses on individual giving.

make grants to that community, and have a board of directors or distribution committee composed of persons from all segments of that community. There are 245 such foundations with total assets of \$1.52 billion. Of \$108 million given in 1980, 75% went to the health, welfare and education fields. All grants made by community foundations are given to local organizations.

#### CORPORATIONS

Last year, for the first time, corporate giving was greater than foundation giving. The new tax laws will allow corporations to take charitable deductions of up to 10% of their taxable income. In the past, the limit on corporate charitable deductions was 5%, but very few companies ever reached the ranks of the 5% givers. In 1980, less than 30% of the two million companies in the U.S. reported making philanthropic donations. The average level of corporate giving is about 1% of taxable income. Because the track record of corporate giving is so limited, this potential source of alternative funding can pose interesting challenges. Unlike foundation sources which are generally short-term in their support, there is a distinct possibility that corporate donors might be willing to provide long-term support.

Check to see if there are regional associations of corporate donors in your area, such as the Donors Forum in Chicago and the Corporate Social Responsibility Association in Philadelphia. These types of organizations are made up of corporate executives who may be helpful in providing information on local giving sources. Their support may also be sought in approaching other companies that are not in the giving group.

#### HINTS ON FOUNDATION AND CORPORATE GIVING

The following hints are offered by legal service program directors and others who have had experience in obtaining grants from foundations and corporations:

- Research the foundations and corporations and identify those that have interests which coincide with the work of your program. (See resources listed under part III of this paper.) Study the geographical limitations on giving, and the subject areas of interest, and concentrate only on those that represent a real possibility. The most common reason why proposals are rejected is that the project doesn't match the interests of the foundation.\* Don't be accused of not doing your "homework."
  
- Watch for deadlines for submitting proposals and the scheduled meetings of boards and grants committees.
  
- The "scattershot" or "shotgun" approach does not work, and it can give you a bad name. This approach has been tested by a few legal service programs, and their experiences confirm the professionals' advice against sending out a large number of proposals without follow-up and without paying attention to matching your proposal with the interests of the potential donor.  
There can be serious negative consequences for those who use this approach. The donor community of foundations and corporations is relatively small, and their leaders meet regularly to discuss trends and exchange information. For example, there are 25 regional associations for foundation executives. Word gets around of grantseekers who are mindlessly sending out proposals, and you may be shunned in the future.
  
- "Foundations fund people, not projects," "Peer solicits peer". These principles have already been described at pages 4 and 10. Emphasize the people you have in your organization, and develop a relationship with the people in the donor organization. Contacts are important in establishing your credibility and in gaining the confidence of the donors. Don't overlook the middle level personnel at foundations. As one program director pointed out, program officers or other middle level personnel sometimes can make smaller grants without going to the board. Those persons also can provide you with lots of helpful information and insights.  
If you do not have a board with helpful ties for fund-raising, examine the possibilities of volunteers, adding new board members or adding an advisory board.
  
- Don't overlook the local foundations, which tend to receive fewer proposals and have been less challenged

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\*A legal service program that wanted to establish neighborhood food co-ops approached corporations that were in the food business and raised \$15-20,000 in the first year with letter solicitations and follow-up.

in the past. The big national foundations may have more money and may give bigger grants, but the competition is more intense for their dollars. National foundations tend to look for novel, innovative projects or for phototype projects that address broad social issues.

- Be persistent and prepared to re-submit your proposal even if it is rejected the first time around. If your proposal fits into the foundation's interest area, it could receive serious consideration a second time around. The foundation's staff may give you insights into how your proposal can be improved, or why it is more timely this year than last. For example, a legal service program received a \$200,000 three-year grant to operate a children's rights project. Prior to making that grant, the foundation had made grants to other groups that offered to address children and juvenile issues through community education programs, publications, and even training programs for juvenile court judges. Those approaches failed, and the foundation then decided to make the grant to the legal service program because of its continuing interest in the field of juvenile rights.
- Watch your rhetoric and bear in mind who will be reading your proposal. At the Boston MEET THE FUNDERS conference, a foundation executive stressed that the people who read your proposals are white, grey-haired and over 50. They are conservative people, so don't turn them off by your language and presentation even before they can get to the substance of your proposal.
- Highlight or concentrate on aspects of your program that would have more appeal. For example, request funding for the services you provide to seniors or battered spouses, which may be far less controversial than tenant advocacy or welfare rights. Select areas that would be of particular appeal to potential donors based on your research.
- Foundations are interested in positive media coverage, publicity. Show them newspaper clippings, and demonstrate the opportunity for good publicity. One program director pointed out that foundations and major donors are "bricks and mortar" oriented. After raising foundation money to make the down payment on the program's building about two years ago, the program held a dinner honoring the donors and had a plaque made for the building. The program now plans to run a capital drive to pay off the mortgage, which is up for refinancing in 1982.
- Private Foundations usually are not interested in paying for operating expenses or maintenance of an existing program. Community foundations, however, are more likely to fund existing programs and provide operating and emergency assistance. Grants generally run for three years or less, and

because foundations like to think that their projects will live forever, they want to know whether the project can become self-sustaining when the grant runs out. One program director describes this as a double-edged sword. If you say that you can become self-sustaining, you may be asked "why not now?" If you indicate that is a problem, you may run the risk of becoming a loser and a poor choice.

- Foundations fund winners, not losers. Emphasize your strengths, and reassure them that you are not going out of business. Crying "poor" is a bad tactic.
- Prepare your budget carefully, paying particular attention to administrative and overhead expenses. You should expect to be asked to absorb the administrative and overhead expenses, because the program "already pays for that anyway". But there are added costs to your program whenever you accept a grant or begin a new project, and you may end up with reduced resources for your ongoing program if a new grant is "barebones" or less. Have a realistic budget and plan in mind, showing breakdowns of personnel and non-personnel expenses associated with the proposed project.
- Check the local telephone directory and go to the trust officers at the local banks to find out about smaller foundations and trusts that will not be listed in any of the publications at the library or bookstore.
- Find out whether you should first prepare a letter proposal. A number of foundations and corporations prefer that you begin by sending a letter proposal, summarizing your request for funding. They will review it and let you know whether a comprehensive proposal should be submitted.

## V. GRASSROOTS FUNDING

Grassroots fund-raising encompasses all of the different ways in which you can raise money within your own community: telephone campaigns, events (cocktail parties, picnics, raffles, dinners), direct mail solicitations and door-to-door campaigns. It requires not only staff but also a cadre of volunteers, and it can take years to develop a viable campaign. But once developed, grassroots funding can provide a stable, long-term source of funding.

One legal service program that has looked into direct mail campaigns determined that it requires contacts and creative and administrative services that could best be handled by a professional fund-raising firm. Their proposed solicitation package involved an initial solicitation or test mailing to 50,000 persons with at least one follow-up mailing. The budget included \$5,000 for professional fees (creative design and administration) plus \$9,338 for the initial mailing:

Professional Fees		\$ 5,000
Test mailing of 50,000 pieces		
Postage (\$39.80/thousand)	\$ 1,990	
Permit (\$1/thousand)	50	
Envelopes	895	
Printing	4,225	
Mailing house (\$17.50/thousand)	875	
Lists rental (\$15.06/thousand)	753	
Brokering and promotional fees (\$11/thousand)	550	
	\$ 9,338	<u>9,338</u>
		\$ 14,338

As planned, the 50,000 initial mailing would give some indication of the feasibility of direct mail solicitations for a local program. If the initial mailing yielded a 1% return, the program planned to do a second mailing to a group of 250,000.\* Based on its research and consultations with professional firms, the legal service program expected the direct

\*A 1 to 2% return on a test mailing apparently is a signal to continue. Once a donor list is developed, you may get up to 80% returns on donor list mailings according to a professional firm.

mail campaign to be at least a three year effort: the first year of operations would be at a loss; the second year would be a year to break even and possibly see some profit; and the third year would be when the donor list would be building and profits expected.

(Some of the resource materials and training programs on grassroots fund-raising are listed under Part III.)

#### UNITED WAY

According to LSC program statistics, 72 programs are already receiving funds from United Ways. Of these 72 programs, 87.5% receive funds that account for 10% or less of their total budgets. The majority (62.5%) in fact receive funds that account for 5% or less of their total budgets. United Ways are a \$1.5 billion operation. There are about 2,300 local chapters, and United Way of America (801 North Fairfax Street, Alexandria, Virginia 22314, (703) 836-7100) serves as their national office. The national office provides supportive services such as training, planning assistance, labor relations, national agency relations and research and data collection. Each local United Way operates autonomously, and local membership and allocation procedures vary from one community to another.

A number of traditional charities, such as the Boy Scouts and YWCA, receive more than half of United Way funds nationally. The success of United Way is due to a number of factors: highly sophisticated print and audio visual promotional pieces; nationwide media coverage; workplace solicitation and payroll deduction plans; and trained volunteers and staff.

Where United Way local chapters are small, it may be very difficult for a newcomer to enter the system. In some areas, for example,

with United Ways' annual giving campaigns. There may also be restrictions on your ability to approach certain foundations or corporations which are major contributors to United Way. Inquire about such restrictions before deciding to join United Way.

Legal Service programs should be aware of the fact that they can tap into the workplace solicitation method without joining United Ways. Employee payroll deductions, which are the chief form of workplace solicitation, account for over \$1 billion annually. Until very recently, United Ways were the only beneficiaries of this method, but the number of other charitable organizations participating in workplace solicitations is likely to increase. The two primary avenues open are private and government workplaces. The success and growth of the United Ways prove the viability of the concept, which should be seriously considered by legal service programs.

Further information on United Ways (pros and cons) and the feasibility of workplace solicitations may be obtained by contacting Robert Bothwell at the National Committee for Responsive Philanthropy, 810 18th Street, N.W., Suite 408, Washington, D.C. 20006, (202) 347-5340. See page 25 regarding an upcoming conference on workplace solicitation. Also, the September-October issue of NLADA FUNDING NEWS will feature an article on individual giving and discuss this method of fund-raising.

United Ways are broken down not only by counties but by cities as well, with each chapter having its own favorite charities.

United Way funding can be a stable source for legal service programs. In addition, there may be contingency funds available through United Ways to meet emergency or unexpected needs. One urban program, for example, received a \$15,000 grant from the United Way contingency fund in order to purchase two word processing machines (as replacements for outmoded/leased machinery).

There are two possible drawbacks to United Way funding which should be considered. First, a local United Way may be highly politicized and may try to exert pressure against involvement in "controversial" issues. Legal service suits against hospitals and utility companies in some areas, for example, have caused problems between the program and United Way. What normally happens is that the unhappy defendant (hospital, utility company) threatens to cut off its contributions to United Way because of the funds given to the legal service program, and United Way then turns to the program. It may be possible to avoid such situations by having United Way monies designated for certain non-controversial aspects of a program's services, such as senior citizens or family law. One program receives United Way funds (about 8% of the program's budget) which cannot be used to support legislative advocacy, class actions, or regulatory work, and finds this a workable solution to the political problem.

Second, each local United Way has its own set of restrictions on the ability of member agencies to conduct fund-raising activities. There may be a moratorium period when member agencies are prohibited from any independent fund-raising -- usually in the fall so as not to interfere

## VI. BAR ASSOCIATIONS

State and local bar associations can be a source of alternative funding. This year, 26 LSC recipients reported receiving funds from bar associations. All received funds that accounted for 10% or less of their total budgets; in fact, 25 out of 26 received sums that accounted for 5% or less of their total budgets. (Bar association support may be difficult or impossible to obtain in areas where the bar is already sponsoring a separate legal aid program.)

One method of raising funds from the bar is to seek an assessment from all members of the association. In a small mid-western county, for example, a local program receives about \$7-8,000 annually from the county bar association. There are about 200 attorneys in the bar association, and each is assessed \$40 for purposes of supporting the legal service program. This assessment is equal to or greater than the membership dues, which range from \$20 to \$40 per member, depending on the years out of law school. The bar association collects the assessment and is responsible for pursuing any reluctant payers. The program has found that a majority of local attorneys feel that this arrangement is worthwhile because it is desirable from their perspective to have a legal service program in town. Private attorneys like having a place to which they can refer persons who are unable to pay fees or are otherwise "not desirable."

Where there are 6,600 attorneys in the local bar association, a legal service program uses the bar association's mailing labels in order to conduct an annual membership drive for the program. A copy of the program's annual report is included with the solicitation letter, and attorneys are asked to pay a minimum of \$25 for membership. This solicitation is done in late fall (usually November) to take advantage

of the tax write-off season. (The program belongs to United Way but is allowed to do this because it is organized as a membership corporation and membership drives are permitted by the local United Way.) About \$10-12,000 is raised through this effort.

A more selective mailing to 400 attorneys in a large urban area yield about \$12,000 for another program. That program expects to raise even more money from the bar this year by involving members of its board of directors and having a telephone follow-up system after the solicitation letters have been sent.

In some communities, bar associations and individual members may not be interested in donating funds to a legal service program. However, they may be interested in funding a separate pro bono project, or in working with you to set up a pro bono referral system. Legal service programs should encourage such efforts and work with bar groups for several reasons. A pro bono referral system will expand the services available to low income persons in the community. By having input in the design and operation of such a system, program staff will be able to work with the private bar in case selection, training, co-counseling and other follow-up services to ensure quality legal services.

## VII. STATE AND LOCAL FUNDING

FILING FEES

Add-ons to filing fees offer the possibility of a relatively stable source of local funding. You can get rough estimates of potential income from filing fees by examining how many cases are filed annually at different levels of your state court system, and in your county in particular. You should also analyze what the filing fees are now used for -- in Washington state, for example, the fees are used in part to pay for judges' salaries. By knowing whose interests may be threatened by your efforts to have a share of filing fees, you can realistically determine whose support you'll need and how tough the battle will be to obtain this kind of funding.

Programs that are receiving income from filing fees advise that because legislation is involved, you will need the support of local politicians, state legislators, bar leaders and other influential persons.

The state of Nevada passed a statute about six years ago (NRS 19.031) which directs the treasurer of each county to set aside a portion of every filing fee to be paid over to the legal service program in that county. Initially, the statute called for \$1.50 to be added to then-existing filing fees; the amount was raised to \$3.00 about 3 years ago. Washoe Legal Services receives about \$44,000 annually from this source. However, as their experience shows, this source of funding is vulnerable to political pressures. The program recently won an \$80,000 attorney fee award in a prisoners' rights case. In reaction, the Nevada legislature voted last summer to amend its filing fee add-on statute, providing that if a legal service program accepts and receives an award of attorney fees assessed against the state, the county shall

withhold that program's share of filing fees and pay the monies over to the state until full reimbursement has been made for the attorney fee award. (A copy of the Nevada statute is attached.)

Oregon also has a filing fee statute which is expected to generate about \$700,000 for legal services in 1982. The add-ons are \$3.00 for district court cases and \$7.50 for circuit court cases.

The Atlanta Volunteer Lawyers Foundation, which is a pro bono program, is fully supported by a filing fee add-on that generates an income of about \$75,000 annually. About two years ago, the state legislature passed special legislation designed to affect only Fulton County (where Atlanta is located), authorizing the state court to impose an additional \$1.00 on all filing fees (except small claims matters) for the support of a volunteer legal service program. Program personnel said that the Young Lawyers Section of the Atlanta Bar Association was responsible for starting up the program and spearheading the effort to win the support of the county commissioners and state legislators. Because they sought to adopt a program that would affect only Fulton County, they did not have to deal with legislators from the other 158 counties of Georgia. Special legislation generally will be passed if you can demonstrate support from local officials and the legislators from the affected area. (A copy of the Georgia House Bill 628 is attached.)

Florida (FS 28.241, 34.041) has a law which allows local jurisdictions to impose filing fee add-ons for the purpose of supporting law libraries and/or legal service programs. The statute does not set an amount or limit to add-ons, which are to be determined on a county by county basis by local commissioners. Not all counties are participating in this plan, which has been in effect about 4 years. The amount of each add-on varies, from \$1.50 on up. One program, which is 100% locally

funded, receives about 60% of its one-half million dollar budget from filing fee add-ons, which are the highest in the state: \$12.50 for circuit court and \$7.50 for county court. That program, which is bar-sponsored, first obtained funds from filing fee add-ons long before the present Florida statute was enacted. They began by obtaining special legislation that affected only their county (like the Atlanta program), and only recently did the state extend the availability of filing fee add-on funding to all counties.

#### OTHER STATE AND LOCAL FUNDING

(A few examples of other kinds of state and local funding are provided.)

The Hawaii statewide program receives about 56% of its budget from the state through legislative appropriation. That appropriation is a part of a general fund appropriation by the legislature to the Hawaii Office of Economic Opportunity. This support goes back to pre-OEO days. Key supporters over the years have been the state bar association, legislators (including some who are former staff attorneys), and other state officials. Although this has been a fairly secure funding source over the years, efforts were made at the last legislative session to impose restrictions on program activities. An effort to prohibit class actions failed this year, but the legislature has signalled its intent to re-examine that issue next year. In the past, the program has received two-year appropriations at a time, but the last appropriation given to the program is for one year only. There is a reimbursement provision for attorney fees collected by the program from the state:

"all attorney fees awarded, ordered, stipulated to or collected...against any state agency or office...shall be paid from or set-off against the sum appropriated."

The conference committee report on the Hawaii legislation expresses the mood of the legislators:

"Your Committee notes with concern the class action suits which the Society has instituted against the State and from which it has collected attorney's fees in addition to appropriations made by the State. Your Committee encourages the Society to discontinue this type of action and to concentrate its endeavors on assisting the individual families which are their clients."

(A copy of the Hawaii bill and conference report excerpt are attached.)

Evergreen Legal Services in Washington has been receiving funds under contracts with the State since 1972 to serve institutionalized persons. The amounts have been as high as \$500,000 in one year, and probably will be about \$300,000 this year. The funds are used to provide services to persons in correctional, mental health and juvenile institutions. The program director said that this arrangement works well because the funds are adequate to set up a separate project and not distract from the program's overall priorities. He and the project attorney/director have developed relationships with the bureaucracies that oversee the institutions being served, and those relationships have been the key to securing such funds. Again, there are political problems -- the state is upset because of the conditions suits filed by the project, and has now put the legal service contracts up for bid for next year.

The state of Minnesota just enacted a statute that allows counties to levy 1/4 mil on property taxes for the support of legal service programs. This statute was the idea of legislators, not the legal service programs. The program personnel must now follow through on a county by county basis, and they see an uphill battle ahead. So far, there is no clear reading on whether county support can be obtained to raise property taxes for legal services.

## VIII. CLIENT TRUST FUND PLANS

A client trust fund plan involves taking the interest earned (or investment income derived) from the client funds held in escrow by attorneys and using the monies for the support of legal service staff programs, support centers, law student scholarships, and other bar-related nonprofit activities. The rationale for the development of such plans is simple. Since most client trust funds held by lawyers are relatively small in amount and held for short periods of time, it is often impractical to establish a separate account for each client or to invest each client's funds to earn interest. For these reasons, lawyers have held client funds generally in a common non-interest bearing checking account, where no one benefits (except the banks). On an average daily balance basis, the amounts of monies held in such accounts can be substantial, and they are capable of earning significant amounts of interest. Under a client trust fund plan, the interest earned on client trust funds held in common accounts would be turned over to a nonprofit organization (such as a bar foundation) for the benefit of the general public.

Legal service programs based on attorney trust accounts exist throughout Australia and Canada. In British Columbia, where there are about 3,000 practicing attorneys, about \$2.1 million is generated annually in interest income. The majority of existing client trust fund plans have the following common elements:

1. Interest earned is computed by reference to a minimum or average daily balance in attorney trust accounts.
2. Interest earned is channeled directly to a foundation established by the legal community to receive and disburse the earnings.
3. Earned income is allocated for distribution among various legal programs designed to

improve the administration of justice such as legal aid, a reimbursement plan for lost or stolen client trust funds, scholarships and research.

Two states, Florida and California, have made significant progress in their efforts to have client trust fund plans adopted. The Florida plan was initially proposed by the Florida bar in 1976. The bar, which is regulated by the judiciary in Florida, petitioned the Florida Supreme Court for approval of the plan. The Court first authorized such a plan in early 1978. What followed then was a long series of negotiations with the Internal Revenue Service and an examination of banking regulations. At that time, banking regulations barred payment of interest on funds held in checking accounts, which made it possible that administration of funds by attorneys would involve unwieldy transfers of funds from savings to checking accounts. This obstacle was removed when the Federal Reserve Board began permitting interest-bearing checking accounts, and allowed nonprofit organizations to hold such accounts, 18 U.S.C. 1832(a)(2).

The biggest hurdle for the Florida plan proved to be the I.R.S. rule on "anticipatory assignment of income." The first Florida plan made client participation voluntary -- clients could choose to have their funds placed in the interest-bearing account under the plan, or opt out. The issue was whether clients who participated in the plan would be treated as having received income, with the consequence of their having to claim the interest as income and then take a charitable deduction for the amount given to the bar foundation. If the rule applied, it would impose such an onerous tax reporting requirement for clients and attorneys that the plan would be defeated. It would be unjustifiable for attorneys and clients to be involved in calculating each client's share of interest

and reporting the same to the I.R.S.

Through negotiations with the I.R.S., the Florida bar learned that an unfavorable ruling might be issued because of the client's ability to deprive someone (the bar foundation) of the interest income. The I.R.S. construed this to be the equivalent of a right to control the disposition of income, making it subject to the anticipatory assignment of income rule. As a result of those negotiations, the Florida bar withdrew their request for a ruling from the I.R.S. and petitioned the Florida Supreme Court for an amendment to the plan. The amendment, which was approved in July, eliminated the discretionary aspect of the plan for clients. The Florida plan, as now submitted to the I.R.S. for approval, makes participation mandatory for clients where the trust funds are small in amount or to be held for short periods. An I.R.S. ruling is expected momentarily, and approval seems likely in light of prior negotiations. If approved, the plan can take effect anytime after September 1, 1981 pursuant to the Supreme Court's order. <sup>1/</sup>

Attorney participation under the Florida plan is voluntary. It is too early to tell how many attorneys in Florida will choose to participate in the plan, and so there are no estimates as to the amount of income that might be generated under that plan.

The California plan, which is now going through the state legislative process, makes participation by attorneys mandatory and, like the Florida plan, requires that any client trust funds that are "nominal in amount or are on deposit for a short period of time" be deposited in interest-bearing accounts under the plan. Because the California plan requires that all attorneys maintain trust fund accounts pursuant to the plan, it is expected to begin generating

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<sup>1/</sup>The IRS issues a favorable ruling on the Florida Plan on August 31, 1981 -- see Appendix for copy.

significant sums of interest income as soon as it is implemented. (The legislation provides, however, that no funds may be disbursed until 10 months after the plan becomes operational.) There are about 70,000 attorneys in California, and the estimates of income expected under the trust fund plan range from \$500,000 to \$10 million. The monies would go to the Office of Legal Services of the State Bar, which will then use a nondiscretionary formula for disbursement to legal service programs, support centers and local bar associations. Allocations will be based on poverty populations within each county, limited only by program capacity to use the funds.

(Copies of the Florida and California plans are attached. The outlook for legislative approval in California is good. A senate bill was approved 28-2 earlier this summer, and while the matter was about to be presented to the Assembly, the State Bar withdrew the bill in order to make amendments which would minimize the risk of I.R.S. problems. The Board of Governors of the State Bar approved amendments about a month ago, and the bill has been re-introduced to the legislative process.)

Although the process of getting a client trust fund plan underway in other states will be complex and time-consuming, much of the groundwork has been laid by the proponents of the Florida and California plans. In seeking to implement its plan, the Florida Bar and the Florida Bar Foundation expended hundreds of hours and has already spent \$35,000 on legal fees and other expenses. Another \$20,000 has been committed to their effort.

Another state which is taking a serious look at the plan is Oregon. The Board of Governors of the Oregon State Bar Association recently voted to support the recommendation of its Legal Aid Committee

that a trust fund program be implemented in that state. The recommendation will be submitted to the bar membership at its annual meeting in September.

In 1979, the Conference of Chief Justices of the 50 state courts adopted a resolution endorsing the Florida program and recommending its adoption in other states. One place to begin in your state, therefore, would be with the Chief Justice of your state court.

Pursuing this potential source of alternative funding will require the following:

- Bar Sponsorship is necessary for obvious reasons. The bar leadership and committee system will have to take the lead role in pushing for approval of the plan by the legislature or judiciary, whichever regulates the bar in your state. If, like Florida, your plan is voluntary for attorneys, the bar leadership will also have a continuing role in "selling" the program to its membership.
- Approval By the Legislature or Judiciary, depending on who regulates the bar in your state. Fortunately, you will not be competing for scarce tax dollars or threatening to take money away from others.
- Approval by Federal and State Tax Authorities. An I.R.S. ruling on the Florida plan is expected momentarily, and should resolve the uncertainty about the anticipatory assignment of income rule.
- Banking Industry. Right now, the banks are the only ones who benefit from the existence of common non-interest bearing trust accounts. Gaining their acceptance has not been a significant problem. No major bookkeeping problems are involved for banks. Largely because the banking industry is highly competitive and because banks are interested in maintaining accounts, the resistance of banks has been overcome.
- Public Education. Because of the I.R.S. posture on trust fund plans, client funds will be placed in trust fund accounts under the plan automatically. A public education program will be needed to explain the program to the general public and to reassure the public that the interest monies would not be available to them or anyone else otherwise.

In Florida, when the plan was approved recently by the Supreme Court, there has already been one unfavorable newspaper editorial. If the general public fails to accept the plan, pressure would be placed on individual attorneys not to participate (which can become a significant problem under voluntary participation plans).

The trust fund plan offers a potential for long-term funding with significant amounts involved. In light of proposed amendments to the LSC Act, legal services programs should be anticipating increased involvement with the private bar because of board selection procedures and private bar involvement in delivery. Hopefully, support for client trust fund plans will emerge out of such relationships and provide a stable base of alternative funding for programs.

(REPRINTED WITH ADOPTED AMENDMENTS)  
FIRST REPRINT  
**A. B. 694**

**ASSEMBLY BILL NO. 694—COMMITTEE ON JUDICIARY**

MAY 20, 1981

Referred to Committee on Judiciary

**SUMMARY**—Provides for waiver of attorney's fees against state or county by organizations conducting legal aid programs which accept certain government subsidy. (BDR 2-1911)

**FISCAL NOTE:** Effect on Local Government: No.  
Effect on the State or on Industrial Insurance: No.

**EXPLANATION**—Matter in *italics* is new; matter in brackets [ ] is material to be omitted.

**AN ACT** relating to legal services; providing for a recoupment of attorney's fees otherwise chargeable against the state or a county by certain organizations conducting legal aid programs which accept a certain government subsidy; and providing other matters properly relating thereto.

*The People of the State of Nevada, represented in Senate and Assembly, do enact as follows:*

SECTION 1. NRS 19.031 is hereby amended to read as follows:

19.031 1. In each county in which legal services are provided without charge to indigent persons through a legal aid program organized under the auspices of the State Bar of Nevada, a county or local bar association or a county legal services program, the county clerk shall, on the commencement of any civil action or proceeding in the district court for which a filing fee is required, and on the filing of any answer or appearance in any such action or proceeding for which a filing fee is required, charge and collect a fee of \$3 from the party commencing or appearing in [such] the action or proceeding. [Such fees shall be] *These fees are* in addition to any other fees required by law.

2. On or before the first Monday of each month the county clerk shall pay over to the county treasurer the amount of all fees collected by him pursuant to subsection 1. [The] *Except as provided in subsection 3, the county treasurer shall remit quarterly all such amounts received by him to the organization operating the legal services program.*

3. *If the county treasurer receives notice from the state or a political subdivision that an award of attorney's fees or costs has been made to an organization which receives money pursuant to this section and that he has been*

(a) Deduct an amount equal to the award from the amount to be paid to the organization; and

1 (b) Remit an equal amount to the state or to the political subdivision  
2 which paid the fees or costs at the time when he would have paid it to the  
3 organization.

4 SEC. 2. Section 1 of this act applies with respect to any case pending  
5 on and after the effective date of this act.

6 SEC. 3. This act shall become effective upon passage and approval.

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H : B. NO. 1

excess of the deductible of the appropriate insurance policy of the Harbors Division, and for litigation purposes not provided for by the several insurance policies of the Harbors Division.

HEALTH

SECTION 8. Provided, that if special fund receipts exceed the authorization, the general fund appropriation shall be reduced to the extent of the excess, except as provided elsewhere in this Act.

SOCIAL PROBLEMS

SECTION 9. Provided, that of the general fund appropriation to the Hawaii Office of Economic Opportunity (GOV 860), \$907,300 in fiscal year 1981-82 and \$980,600 in fiscal year 1982-83 shall be for the Legal Aid Society of Hawaii; provided further, that the Legal Aid Society of Hawaii shall submit reports to the Legislature twenty days prior to the convening of each regular legislative session. These reports shall include statements of income, expenditures and accomplishments for the previous fiscal year.

SECTION 10. Provided, that the sum appropriated in Section 9 for fiscal year 1981-82 and for fiscal year 1982-83 to the Hawaii Office of Economic Opportunity (GOV 860) for the Legal Aid Society of Hawaii shall be used to support the

operations of the Legal Aid Society of Hawaii, and that all attorney fees awarded, ordered, stipulated to or collected by the Legal Aid Society of Hawaii against any state agency or officer, after July 1, 1981, which would cause the amount of state funds to exceed the amount appropriated for each respective fiscal year, shall be paid from or set-off against the sum appropriated for each respective fiscal year to the Legal Aid Society of Hawaii.

SECTION 11. Provided, that the amounts shown for Regular Instruction (EDN 105) are intended for student enrollment projections of 164,156 for fiscal year 1981-82 and 163,475 for fiscal year 1982-83.

SECTION 12. Provided, that the general fund appropriation for the Systemwide Support - Institutional Support (UOH 903) includes \$15,000 for each year of the fiscal biennium to be expended at the discretion of the President of the University of Hawaii.

SECTION 13. Provided, that of the sum appropriated to Spectator Events and Shows (AGS 889), a sum not to exceed \$5,000 for each fiscal year of the fiscal biennium 1981-83 shall be authorized by the Stadium Authority to be expended at the discretion of the Stadium Manager for promotion and other Stadium purposes.

SOCIAL PROBLEMS

SECTION 17. Provided, that of the general fund appropriation to the Hawaii Office of Economic Opportunity (GOV 860), \$907,300 in fiscal year 1981-82 shall be for the Legal Aid Society of Hawaii; provided further, that the Legal Aid Society of Hawaii shall submit reports to the Legislature twenty days prior to the convening of each regular legislative session.

~~These reports shall include statements of income, expenditures, and accomplishments for the previous fiscal~~

~~year~~

SECTION 18. Provided, that the sum identified in Section 17 for fiscal year 1981-82 in the Hawaii Office of Economic Opportunity (GOV 860) for the Legal Aid Society of Hawaii shall be used to support the operations of the Legal Aid Society of Hawaii, and that all attorney fees awarded, ordered, stipulated to or collected by the Legal Aid Society of Hawaii against any state agency or officer, after July 1, 1981, which would cause the amount of state funds to exceed the amount appropriated for each respective fiscal year, shall be paid from or set-off against the sum appropriated for each respective fiscal year to the Legal Aid Society of Hawaii.

SECTION 19. Provided that of the general fund appropriation to the Services to Individuals and Families Program (SOC 111),

1 to Services to Individuals and Families (SOC 111), \$77,000  
2 for each year of the fiscal biennium 1981-1983 shall be for  
3 expanding the Senior Companion Program to the Counties of  
4 Hawaii, Kauai, and Maui.

5 SECTION 21. Provided that of the general fund appropri-  
6 ation for Payments to Assist in Child Welfare Foster Care  
7 (SOC 203), \$8,000 in each year of the fiscal biennium  
8 1981-1983 shall be provided for general casualty insurance  
9 for foster parents.

10 SECTION 22. Provided that of the general fund appropri-  
11 ation to the Hawaii Office of Economic Opportunity (GOV 860),  
12 \$907,300 in fiscal year 1981-82 and \$980,600 in fiscal year  
13 1982-83 shall be for the Legal Aid Society of Hawaii;  
14 provided further that the Legal Aid Society of Hawaii shall  
15 submit reports to the Legislature twenty days prior to the  
16 convening of each regular session. These reports shall  
17 include statements of income, expenditures, and accomplish-  
18 ments for the previous fiscal year.

19 SECTION 23. Provided that the sums identified in  
20 Section 22 for each year of the fiscal biennium 1981-1983  
21 in the Hawaii Office of Economic Opportunity (GOV 860) for  
22 the Legal Aid Society of Hawaii shall be used to support the  
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1 operations of the Legal Aid Society of Hawaii, and that all  
2 attorney fees awarded, ordered, stipulated to, or collected  
3 by the Legal Aid Society of Hawaii against any state agency  
4 or officer, after July 1, 1981, which would cause the amount  
5 of state funds to exceed the amount appropriated for each  
6 respective fiscal year, shall be paid from or set off against  
7 the sums appropriated for each year of the fiscal biennium  
8 1981-1983 to the Legal Aid Society of Hawaii.

9 EDUCATION

10 SECTION 24. Provided that of the general fund appropri-  
11 ation to the Other Regular Instruction Programs (EDN 106), \$289,458  
12 for each year of the fiscal biennium 1981-1983 shall be for  
13 the program for Asian/European/Pacific Languages; and  
14 provided further that the Department of Education shall  
15 submit a report on the introduction, continuation and/or  
16 expansion of the foreign language program to the Legislature  
17 at least twenty days prior to the convening of the 1982  
18 regular session.

19 SECTION 25. Provided that of the general fund appropri-  
20 ation to the Other Regular Instruction Programs (EDN 106)  
21 for fiscal year 1981-82, \$151,086 shall be for Project  
22 Holomua; and provided further that of the \$151,086 appropriated,  
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Your Committee has provided additional funds and positions on all islands due to case load increases in the areas of financial assistance, Food Stamps, and Medicaid. Your Committee intends that the error rates of underpayments and overpayments be kept at a minimum to assure the maintenance of federal standards.

Senior companions. Funds have been appropriated to expand the Senior Companion program to the islands of Maui, Kauai, and Hawaii over the next two years. This program, through which senior citizens assist less able senior citizens in their own homes, is designed as a more humane and an effective alternative to institutionalization.

Other concerns. Your Committee is concerned about the lack of systematic plans for review and selection of grant proposals received by the Progressive Neighborhood Program, the Hawaii Office of Economic Opportunity, and the Executive Office on Aging. Your Committee feels that criteria should be established to review all grant requests so that grant funds will be made available to private agencies on a priority basis. The Legal Aid Society has been funded for only one year by this bill. Your Committee notes with concern the class action suits which the Society has instituted against the State and from which it has collected attorney's fees in addition to appropriations made by the State. Your Committee encourages the Society to discontinue this type of action and to concentrate its endeavors on assisting the individual families which are their clients.

Public Safety

Your Committee has taken steps to relieve the overcrowded conditions at the Oahu Community Correctional Center. Funds have been provided to renovate the second floor of the administration building for use as inmate housing and for a site selection study and purchase of land in the Halawa area for a 500-bed, medium-security correctional facility. Additional positions and funds for operation of the new facilities have also been included in the budget.

Your Committee has provided for the installation and maintenance of emergency (automatic dialer) telephones in 30 state parks located in outlying areas. These phones are to be connected directly to police and emergency rescue units, thus providing an alternative park security measure in those

H. B. NO.

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1 in fiscal year 1981-82 shall be used for Basic Grants  
2 Projects; provided further, that the Progressive Neighborhoods  
3 Task Force shall develop a plan for systematic review and  
4 selection of Basic Grants Projects and shall submit that  
5 plan to the legislature twenty days prior to the start of  
6 the 1982 Regular Session.

7 SECTION 36. Provided, that of the general fund appropriation  
8 to the Hawaii Office of Economic Opportunity (GOV 860),  
9 \$907,300 in fiscal year 1981-82 shall be the Legal Aid  
10 Society of Hawaii; provided further, that the Legal Aid  
11 Society of Hawaii shall submit reports to the Legislature  
12 twenty days prior to the convening of each regular legislative  
13 session. These reports shall include statements of income,  
14 expenditures and accomplishments for the previous fiscal  
15 year.

16 SECTION 37. Provided, that of the general fund  
17 appropriation to the Hawaii Office of Economic Opportunity  
18 (GOV 860), \$1,587,715 in fiscal year 1981-82 shall be used  
19 for "other grants in aid"; provided further, that the Hawaii  
20 Office of Economic Opportunity shall develop a plan for  
21 systematic review and selection of "other grants in aid"  
22 and shall submit that plan to the legislature twenty days  
23 prior to the start of the 1982 Regular Session.  
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9277

A BILL TO BE ENTITLED  
AN ACT

1 To provide that in all counties in this State 2  
2 having a population of 600,000 or more according to the 1970 2  
3 United States Decennial Census, or any future such census, 2  
4 the chief judge of the State Court shall designate an agency  
5 to develop, operate, and administer volunteer programs to 2  
6 provide legal services to low-income clients involved in 3  
7 civil actions; to provide for a statement of purpose; to 3  
8 provide for the designation of such agency; to provide for 3  
9 the duties of such agency; to provide for an additional fee  
10 in certain civil actions in the State Court of such 3  
11 counties; to provide for the collection and disbursement of 3  
12 such fee; to limit the use of the proceeds from such fee to 3  
13 certain purposes; to provide for the refund of unused funds; 3  
14 to provide for definitions; to provide for applicability of  
15 this Act; to provide an effective date; to repeal 3  
16 conflicting laws; and for other purposes. 3

17 BE IT ENACTED BY THE GENERAL ASSEMBLY OF GEORGIA: 41

18 Section 1. Statement of purpose. The General 44  
19 Assembly finds that counties in this State with large 45  
20 populations have a large number of poor people who cannot 46  
21 afford legal services. The General Assembly finds that 47  
22 without the assistance of an attorney poor people have great  
23 difficulty in civil matters in the court systems in such 48  
24 counties and that trained legal assistance for these people 49  
25 is essential for the judicial system to function adequately 50  
26 and fairly. The General Assembly finds that the programs  
27 currently in effect to provide legal services in civil 51

1 matters to poor people do not have the resources to meet the 52  
 2 needs of all poor people and, therefore, that it is 53  
 3 necessary to encourage and develop additional legal 54  
 4 resources through the use of volunteer programs to help meet 55  
 5 these needs. Because under the Code of Ethics of the legal 56  
 6 profession volunteer legal representation of poor people is 57  
 7 a duty of all lawyers, the General Assembly finds that it is 58  
 8 in the public interest for the General Assembly to enact 59  
 9 legislation to provide a means to develop, operate, and  
 10 administer programs of volunteer legal services for poor  
 11 people in such counties.

12 Section 2. Creation of a program of volunteer  
 13 legal services to poor people. In all counties in this 63  
 14 State having a population of 600,000 or more according to 64  
 15 the 1970 United States Decennial Census, or any future such 65  
 16 census, the chief judge of the State Court of the county  
 17 shall designate a nonprofit agency to develop, operate, and 66  
 18 administer programs for the provision by attorneys within 67  
 19 the county of volunteer legal services to low-income clients 68  
 20 involved in civil matters within the jurisdiction of courts 69  
 21 within the county. In designating such agency, the judge  
 22 shall consult with the presidents of local bar associations 70  
 23 within the county and with the directors of agencies within 71  
 24 the county providing legal services to low-income clients in 72  
 25 civil matters.

26 Section 3. Duties. The agency designated pursuant 75  
 27 to Section 2 shall have the following duties in carrying out 76  
 28 the provisions of this Act:  
 29 (a) To develop, operate, and administer volunteer 77  
 30 programs among the lawyers within the county to provide 78  
 31 legal services on a volunteer basis to low-income clients 79  
 32 involved in civil matters within the jurisdiction of courts 80

- 1 within the county. 81
- 2 (b) To report annually to the State Court on its 83
- 3 activities conducted pursuant to this Act. 84
- 4 (c) To maintain an appropriate accounting of all 86
- 5 funds received for the purposes of this Act and to prepare 87
- 6 and submit to the State Court an annual statement accounting 88
- 7 for the use of such funds.
- 8 (d) To refund annually all unused funds as 90
- 9 provided in Section 4(d).

10 Section 4. Fees. (a) In all counties in this 9

11 State having a population of 600,000 or more according to 9

12 the 1970 United States Decennial Census, or any future such 9

13 census, there shall be collected by the clerk of the State 9

14 Court of the county, in addition to any other fees or

15 charges authorized by law, a fee of \$1 from the plaintiff or 9

16 other moving party in each civil suit, action, or proceeding 9

17 for which fees are required to be paid by such party. Such 9

18 fee shall be charged only once in each case, shall be

19 charged at the time of filing of the first papers in the

20 action, and shall not apply to cases filed in a small claims

21 division of such court.

22 (b) All fees collected pursuant to subsection (a)

23 during each month shall be paid by the clerk or by the

24 county to the agency designated pursuant to Section 2 no

25 later than the last day of the next calendar quarter after

26 the quarter of the month in which collected.

27 (c) Fees collected pursuant to subsection (a)

28 shall be used by the agency designated pursuant to Section 2

29 only for the public and charitable purposes provided by this

30 Act.

31 (d) In connection with the annual accounting

32 required in Section 3(c), all fees collected pursuant to

33 subsection (a) which have not been disbursed or committed

1 for use in discharging the duties described in Section 3 115  
 2 shall be refunded to the clerk of the State court or to the 116  
 3 county, and such fees shall be used as other unrestricted  
 4 court costs collected by the clerk.

5       Section 5. Applicability. (a) For the purposes 120  
 6 of this Act, the term "State Court" means a court governed 121  
 7 by the Act providing for the organization, jurisdiction, 122  
 8 venue, practice, and procedure of certain courts below the 123  
 9 superior court level; approved March 24, 1970 (Ga. Laws  
 10 1970, p. 679), as now or hereafter amended. 124

11       (b) The provisions of this Act shall apply in all 126  
 12 counties in this State which have a State Court and which ~~127~~  
 13 have a population of 600,000 or more according to the 1970 128  
 14 United States Decennial Census, or any future such census.

15       Section 6. Effective date. This Act shall become 131  
 16 effective on the first day of the second month following the 132  
 17 month in which it is approved by the Governor or in which it 133  
 18 becomes law without his approval; provided, however, the 134  
 19 agency designated pursuant to Section 2 of this Act shall  
 20 not be required to perform the duties provided by Section 3 135  
 21 until thirty days after the receipt of the initial payment ~~136~~  
 22 under Section 4(b). ~~137~~

23       Section 7. Repealer. All laws and parts of laws 139  
 24 in conflict with this Act are hereby repealed. 140

# AGENDA ITEM

-270-

JULY 151

Client Trust  
Fund Legislation -  
Amendments (SB 713)

July 8, 1981

TO: MEMBERS, BOARD OF GOVERNORS  
FROM: State Funding Committee, Legal Services Section  
RE: RECOMMENDATION FOR AMENDMENTS TO SB 713 (CLIENT TRUST FUND LEGISLATION)

I. Summary of Effects of Proposed Amendments

This proposal, which would direct that nominal short-term deposits from clients be placed in an unsegregated interest bearing trust account, would have the following effects:

- (1) Attorneys would retain the discretion they now have as to how client trust funds are to be disbursed.
- (2) No new administrative burdens or ethical duties would be created for lawyers.
- (3) This proposal would simply result in a shift of these many small sums of money from non-interest bearing trust accounts, which are of temporary benefit only to the banks affected, to interest bearing accounts which can be utilized in the public interest for legal services for the needy.
- (4) Clients would not be deprived of any interest or funds which they otherwise are able to currently obtain.
- (5) Where the sum of the client deposit or its duration make it financially practicable, the attorney will retain discretion to place this money in a separate interest bearing trust account, with the interest payable to the client.
- (6) These amendments are essential in order to satisfy the requirements of the IRS that clients have no vestige of control over the disposition of the interest earned if this income is to be exempt from taxation.
- (7) This proposal is the single most promising fiscal alternative for salvaging legal services for lower income people in California.

## II. Background and Necessity for Amendments

Since the introduction of Senate Bill 713 in March, 1981 and its passage in the State Senate with restrictive amendments in early May, there have been several intervening developments at the federal level that indicate a serious need for some modification of the current client trust fund bill if it is to accomplish its purpose of providing funds for legal services programs for the poor.

First, in reviewing a similar client trust fund proposal sponsored by the Florida Bar Foundation, the IRS has indicated that any client veto over the placement of funds in a commingled, interest bearing account would mean that interest actually transferred to the Bar Foundation for charitable purposes would constitute an assignment of income by individual clients and would have to be reported by them on their income tax returns. The IRS's position applies equally to the opt-out provision first favored by the State Bar and the opt-in amendment which was inserted on the Senate floor.

The main assumption underlying both the California and Florida client trust fund proposals is the impracticability of attributing interest to clients when trusts amounts are nominal or held for only a short time. The IRS's position, in effect, forecloses the exercise of any client control over whether nominal or short-term funds go into a commingled, non-interest bearing account or a commingled, interest bearing account. It does not affect a client's or an attorney's decision to place trust funds in a separate interest bearing account for the benefit of the client.

The second set of developments concerns continued federal funding for legal services, something which is now in serious jeopardy. The House of Representatives has authorized \$240 million with severe restrictions on how those funds are to be distributed. The Senate has authorized only \$100 million. The current federal budget for legal services is \$321 million. President Reagan's top advisors are reported as having advised him to veto any authorizing legislation for legal services for the poor. It is virtually a certainty that there are not the votes in either house to override a veto.

Even under the highest funding figure now possible, California legal services programs will be hard hit, especially if the formula proposed by the House of Representatives for equalizing the distribution of funds on the basis of poor people per county is adopted as part of the final legislation. Primarily due to a higher cost of living factor, many California programs have been funded at higher rates than programs elsewhere. It is estimated that the application of the House formula will mean that California programs will be confronting cutbacks ranging from 25% to 77%.

For example, San Francisco Neighborhood Legal Assistance Foundation will have its federal funding reduced approximately 70%; San Mateo Legal Aid will be cut 73%; Alameda County, Legal Aid will face a reduction of about 60%. The total estimated cut in federal funds for basic legal services programs in the state would be about \$10,000,000 under the best funding possibilities.

This does not take into account the highly uncertain fate of the six national support centers in California which currently receive approximately \$3,300,000 in federal funds.

In response to the IRS's position, the Florida Bar Foundation has petitioned the Florida Supreme Court for a modification of the Interest on Trust Account Program previously established by the court so that attorneys have only two options when placing client funds in trust accounts. The attorney may place such funds either in separate interest bearing accounts with interest payable to the client or in commingled interest bearing accounts with the interest payable to the Florida Bar Foundation. The attorney does not have the option to place such funds in a traditional non-interest bearing account.

The revised Florida proposal maintains the dual option structure now available to attorneys and clients in the handling of trust funds. The difference is that when it is impracticable to place client funds in a separate interest bearing account for the benefit of the client the alternative option is an interest bearing rather than a non-interest bearing account.

Given Florida's experience with the IRS and recent developments concerning legal services funding, the most responsible and prudent course of action by the State Bar would be the sponsorship in the State Assembly of amendments to the pending legislation modeled after those currently before the Florida Supreme Court. Any significant variation from the Florida proposal invites, at the very least, additional IRS delay and, in all likelihood, new uncertainty regarding IRS's final position. Although the California trust fund proposal was originally seen as a method for supplementing federal funding. Added delay and uncertainty might mean that much needed financial relief would be too late for some programs.

As former State Bar President Seth Hufstedler noted at the June 20th meeting on legal services sponsored by the State Bar, the interest on client trust fund proposal is the most likely source of new funds for legal services. In light of the State's tight budget, we cannot expect funding from general revenue funds. Nor can we expect funding from special increases in court filing fees or from special surcharges on attorneys' fees awards even if such measures were to be enacted. While there are some notable exceptions, legislatures do not as a rule like to tie specific expenditures to particular revenue sources. There is also little reason to expect a dramatic increase in private, charitable support for legal services. Lastly, there is no reason to believe that a substantial increase in State Bar dues to support legal services for the poor will be any more popular with the State Bar membership than any other past or present proposal for a dues increase.

It would appear, therefore, that the adoption of a client trust fund proposal along the lines now proposed by Florida is the single most promising fiscal alternative for weathering the financial storm that is about

to descend upon California legal services programs. It would further help alleviate the very serious ethical problems described at the June 20th conference which will otherwise confront the bar.

III. Attachments:

For your information, the following material is appended:

- (1) A proposed set of amendments to SB 713 which parallel the pending Florida plan (Tab 1).
- (2) The June 30, 1981 letter opinion of pro bono tax counsel at O'Melveny & Myers outlining the IRS's current position on this subject and recommending that the surest way of complying with the Internal Revenue Code is for this legislation to be amended so that it is substantially similar to the Florida State Bar's program (Tab 2).
- (3) SB 713 (as amended in Senate May 14, 1981) (Tab 3).
- (4) Petition of the Florida Bar Foundation, filed March, 1981 seeking similar amendments to its trust fund program and stating the legal rationale (Tab 4).
- (5) Los Angeles Daily Journal article (July 2, 1981, page 1) which describes the utterly devastating impact on legal services programs which will occur under even the best of the alternative budget cut alternatives now pending in Congress (Tab 5).
- (6) An outline analysis of the resource options open to the bar for the delivery of legal services to the needy (Tab 6).

IV. Recommendation & Proposed Resolution:

That the Board of Governors approve the attached amendments and authorize the undertaking of efforts to promptly meet with key Assembly leaders and with State Senator Nicholas Petris, the principal author of SB 713, to inform them of the need for these amendments in the legislation and to propose their adoption in order to avoid IRS reservations concerning the assignment of interest income and to expedite the availability of new funds for California legal services programs for the poor.

Proposed Amendments to Senate Bill 713

AMENDMENTS

Delete Section 6211 and add the following new section:

6211. An attorney or law firm, which in the course of the professional practice of law receives or disburses trust funds, shall establish and maintain an interest bearing demand trust account and shall deposit therein all client funds that are nominal in amount or are on deposit for a short period of time. All such client funds may be deposited in a single account. The interest earned on all such accounts shall be paid to the State Bar of California to be used for the purposes set forth in this article.

Delete Section 6212 entirely and add the following new sections:

6212. An attorney or law firm which establishes and maintains an interest bearing demand trust account under this article shall comply with all of the following provisions:

(a) The interest bearing trust account shall be established with a bank or savings and loan association which is authorized by federal or state law to do business in California and which is insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation.

(b) The rate of interest payable on any interest bearing demand trust account shall not be less than the rate paid by the depository institution to regular, non-attorney depositors. Higher rates offered by the institution to customers whose deposits exceed certain time or quantity minima, such as those offered in the form of certificates of deposit, may be obtained by a lawyer or law firm so long as there is no impairment of the right to withdraw or transfer principal immediately (except as accounts generally may be subject to statutory notification requirements), even though interest may be sacrificed thereby.

(c) The depository institution shall be directed:

(1) to remit interest or dividends, as the case may be, on the average monthly balance in the account, at least quarterly, to the State Bar;

(2) To transmit with each remittance to the State Bar a statement showing the name of the lawyer or law firm for whom the remittance is sent and the rate or interest applied; and

(3) to transmit to the depositing lawyer or law firm at the same time a report showing the amount paid to the State Bar, the rate of interest applied, the average account balance for each month of the period for which the report is made, and a remittances to the State Bar made during that same period.

(d) In those instances where the amount of the client balance or the duration of deposit render it financially practicable, the attorney may exercise discretion to arrange special investments, not limited to savings accounts, for deposit of client funds with any interest obtained payable to the client.

Exhibit 1 (page 2)

rec'd 7/6/81

LAW OFFICES OF  
O'MELVENY & MYERS

611 WEST SIXTH STREET  
LOS ANGELES CALIFORNIA 90017  
TELEPHONE (213) 820-1120  
TELEX 87-4122  
CABLE ADDRESS MOMS

300 CENTURY WEST EAST  
LOS ANGELES CALIFORNIA 90007  
TELEPHONE 213-150-8700  
TELEX 87-4027  
910 NEWPORT CENTER DRIVE  
NEWPORT BEACH CALIFORNIA 92660  
TELEPHONE (714) 760-8600 22-670 20  
TELEX 87-4122  
1800 M STREET N.W.  
WASHINGTON D.C. 20036  
TELEPHONE 202-417-5300  
TELEX 89-822  
4 PLACE DE LA CONCORDE  
PARIS 8<sup>e</sup> FRANCE  
TELEPHONE 265 39 33  
TELEX 847-660715

June  
30th  
1 9 8 1

OUR FILE NUMBER  
170,445-215

Mr. Robert J. Cohen  
Executive Director  
Legal Aid Society of Orange County  
2700 North Main Street, 11th Floor  
Santa Ana, CA 92701

Re Investment of Client Funds, SB 713: Internal Revenue Service Ruling

Dear Bob:

This letter follows up on my letter of May 27, 1981. I was asked to comment on the various options open to the State Bar to assure that California's program for the investment of client funds will comply with the requirements of the Internal Revenue Code. It appears to me that the most direct and sure way of complying with the Internal Revenue Code is for California to amend its program so that it is substantially identical to Florida State Bar's program. Of course, it is impossible to be certain exactly what the Internal Revenue Service will say until the Florida State Bar receives its ruling. However, it appears that the Internal Revenue Service's requirements will be met only if the program is entirely mandatory, i.e. funds held by attorneys for the benefit of their clients must be invested in an interest-bearing account, the interest on which must be paid either to the client or to the State Bar, depending on the size and length of the deposit.

As described in my letter of May 27, it is possible that a ruling could be received on a program which gave each attorney some discretion as to his or her participation in the program. It is unclear whether a favorable ruling would be received for such a program and the ruling process would almost assuredly be longer than would be the case if the California State Bar's program were entirely mandatory.

EXHIBIT 2

- Mr. Robert J. Cohen - June 30, 1981

The third alternative is to have legislation enacted which would allow a discretionary program. It seems to me unlikely that such legislation could be passed quickly, and there is, of course, some doubt whether it would be passed at all.

In conclusion, the most expeditious method of assuring compliance with the Internal Revenue Service's requirements is to convert the California program to a mandatory program on which it appears Florida will receive a favorable ruling.

If you have any further questions or I can be of further assistance, please call.

Sincerely,

Dean M. Weiner  
for O'MELVENY & MYERS

DW:arc

cc: Mark Aaronson, Esq.  
Harvey Freed, Esq. ✓

Exhibit 2 (pg. 2)

5/21/81

AMENDED IN SENATE MAY 14, 1981

SENATE BILL

No. 713

Introduced by Senators Petris, Keene, and Sieroty Senator  
*Petris**(Principal coauthor: Senator Rains)**(Coauthors: Senators Keene, Sieroty, Greene, and  
Robbins)**(Coauthors: Assemblymen Agnos, Alatorre, Bane, Bates,  
Berman, Chacon, Greene, Levine, Lockyer, Roos,  
Rosenthal, Torres, Maxine Waters, and Wray Wray, and  
Johnston)*

March 18, 1981

---

An act to add Article 14 (commencing with Section 6210) to Chapter 4 of Division 3 of the Business and Professions Code, relating to the State Bar of California.

## LEGISLATIVE COUNSEL'S DIGEST

SB 713, as amended, Petris. State Bar of California.

Existing law does not authorize the State Bar of California to establish a program whereby an attorney or law firm may establish an interest bearing trust account for client funds, the earnings on which are to be paid to the State Bar to be used for programs for free legal services to indigent persons, especially underserved client groups, as specified.

This bill would authorize such a program, which would become operative upon the adoption of a specified resolution by the Board of Governors of the State Bar. It also would authorize qualified legal services projects and support centers receiving funds under the program to use the funds to provide work opportunities with pay, and where feasible, scholarships for disadvantaged law students, to help defray their law school expenses.

Vote: majority. Appropriation: no. Fiscal committee: no.

State-mandated local program: no.

*The people of the State of California do enact as follows:*

1 SECTION 1. Article 14 (commencing with Section  
2 6210) is added to Chapter 4 of Division 3 of the Business  
3 and Professions Code, to read:

4 Article 14. Funds for the Provision of Legal Services  
5 to Indigent Persons

6  
7  
8 6210. The Legislature finds that, due to insufficient  
9 funding, existing programs providing free legal services  
10 in civil matters to indigent persons, especially  
11 underserved client groups, such as the elderly, the  
12 disabled, juveniles, and non-English-speaking persons, do  
13 not adequately meet the needs of these persons. It is the  
14 purpose of this article to expand the availability and  
15 improve the quality of existing free legal services in civil  
16 matters to indigent persons, and to initiate new programs  
17 that will provide services to them. The Legislature finds  
18 that the use of funds collected by the State Bar pursuant  
19 to this article for these purposes is in the public interest,  
20 is a proper use of the funds, and is consistent with  
21 essential public and governmental purposes in the  
22 judicial branch of government. The Legislature further  
23 finds that the expansion, improvement, and initiation of  
24 legal services to indigent persons will aid in the  
25 advancement of the science of jurisprudence and the  
26 improvement of the administration of justice.

27 6211. An attorney or law firm may establish an  
28 interest bearing trust account for unsegregated client  
29 funds pursuant to this article, the earnings on which shall  
30 be paid to the State Bar of California to be used for the  
31 purposes set forth in this article. All client funds may be  
32 deposited in a single account.

33 6212. An attorney or law firm which elects to establish  
34 an interest bearing trust account under this article shall  
35 comply with all of the following provisions:

36 (a) The interest bearing trust account shall be

1 established with a bank or savings and loan association  
2 which is authorized by federal or state law to do business  
3 in California and which is insured by the Federal Deposit  
4 Insurance Corporation or the Federal Savings and Loan  
5 Insurance Corporation.

6 (b) Client funds in the interest bearing trust account  
7 shall be subject to withdrawal, or to transfer to a trust  
8 checking account, upon request and without delay.

9 (c) An attorney or a law firm electing to deposit client  
10 funds in an interest bearing trust account shall direct the  
11 depository institution to remit the interest or dividends  
12 earned on the account, less *reasonable* service charges, if  
13 any, to the State Bar of California.

14 (d) Attorneys and law firms electing to deposit client  
15 funds in interest bearing trust accounts shall transmit to  
16 each client for whom the funds are held, or will be held,  
17 the client notice form described in this subdivision.

18 The content and language of the client notice form  
19 shall be determined by the State Bar, but the content  
20 shall, at a minimum, include both of the following  
21 statements:

22 (1) That attorneys are authorized by law to place  
23 client trust account funds in interest bearing, as well as  
24 noninterest bearing, accounts, and that utilization of an  
25 interest bearing account will result in the interest, less  
26 administrative costs, being distributed by the State Bar to  
27 local legal programs designed to expand the civil legal  
28 services to indigent persons.

29 (2) That absent an indication to the contrary by a  
30 client to his or her attorney the trust funds will be  
31 deposited in an interest bearing account.

32 The State Bar shall print and maintain an adequate  
33 supply of the client notice forms and shall distribute the  
34 forms without charge to any person who so requests.  
35 6213. As used in this article:

36 (a) "Qualified Legal Services Project legal services  
37 project" means a nonprofit project incorporated and  
38 operated exclusively in California which provides as its  
39 primary purpose and function legal services without  
40 charge to indigent persons and which has quality control

1 procedures approved by the State Bar of California.

2 (b) "Qualified Support Center support center" means  
 3 an incorporated nonprofit legal services center, which  
 4 has as its primary purpose and function the provision of  
 5 legal training, legal technical assistance, or advocacy  
 6 support without charge and which actually provides  
 7 through an office in California a significant level of legal  
 8 training, legal technical assistance, or advocacy support  
 9 without charge to qualified legal services projects on a  
 10 statewide basis in California.

11 (c) "Recipient" means a qualified legal services  
 12 project or support center receiving financial assistance  
 13 under this article.

14 (d) "Indigent person" means a person whose income  
 15 is (1) 125 percent or less of the current poverty threshold  
 16 established by the United States Office of Management  
 17 and Budget, or (2) who is eligible for Supplemental  
 18 Security Income or free services under the Older  
 19 Americans Act or Developmentally Disabled Assistance  
 20 Act. With regard to a project which provides free services,  
 21 attorneys in private practice without compensation,  
 22 "indigent person" shall also mean a person whose income  
 23 is 75 percent or less of the maximum levels of income for  
 24 lower income households as defined in Section 50079.5 of  
 25 the Health and Safety Code. For the purpose of this  
 26 subdivision, the income of a person who is disabled shall  
 27 be determined after deducting the costs of medical and  
 28 other disability-related special expenses.

29 (e) "Fee generating case" means any case or matter  
 30 which, if undertaken on behalf of an indigent person by  
 31 an attorney in private practice, reasonably may be  
 32 expected to result in payment of a fee for legal services  
 33 from an award to a client, from public funds, or from the  
 34 opposing party. A case shall not be considered fee  
 35 generating if adequate representation is unavailable and  
 36 any of the following circumstances exist:

37 (1) The recipient has determined that free referral is  
 38 not possible because of any of the following reasons:

39 (A) The case has been rejected by the local lawyer  
 40 referral service, or if there is no such service, by two

1 "attorneys in private practice who have experience in the  
 2 subject matter of the case.

3 (B) Neither the referral service nor any attorney will  
 4 consider the case without payment of a consultation fee.  
 5 (C) The case is of the type that attorneys in private  
 6 practice in the area ordinarily do not accept, or do not  
 7 accept without prepayment of a fee.

8 (D) Emergency circumstances compel immediate  
 9 action before referral can be made, but the client is  
 10 advised that, if appropriate and consistent with  
 11 professional responsibility, referral will be attempted at  
 12 a later time.

13 (2) Recovery of damages is not the principal object of  
 14 the case and a request for damages is merely ancillary to  
 15 an action for equitable or other nonpecuniary relief, or  
 16 inclusion of a counterclaim requesting damages is  
 17 necessary for effective defense or because of applicable  
 18 rules governing joinder of counterclaims.

19 (3) A court has appointed a recipient or an employee  
 20 of a recipient pursuant to a statute or a court rule or  
 21 practice of equal applicability to all attorneys in the  
 22 jurisdiction.

23 (4) The case involves the rights of a claimant under a  
 24 publicly supported benefit program for which  
 25 entitlement to benefit is based on need.

26 (f) "Legal Services Corporation" means the Legal  
 27 Services Corporation established under the Legal  
 28 Services Corporation Act of 1974, (Public Law 93-355; 42  
 29 U.S.C. 2996 and following).

30 (g) "Older Americans Act" means the Older  
 31 Americans Act of 1965, as amended (Public Law 89-73; 42  
 32 U.S.C. Sec. 3001 and following).

33 (h) "Developmentally Disabled Assistance Act"  
 34 means the developmentally Disabled Assistance and Bill  
 35 of Rights Act of 1975, as amended (Public Law 94-103; 42  
 36 U.S.C. 6001 and following).

37 (i) "Supplemental security income recipient" means  
 38 an individual receiving or eligible to receive payments  
 39 under Title XVI of the Social Security Act, or payments  
 40 under Chapter 3 (commencing with Section 19090) of

1 of Division 9 of the Welfare and Institutions Code.  
 2 6214. (a) Projects meeting the requirements of  
 3 subdivision (a) of Section 6213 which are funded either  
 4 in whole or part by the Legal Services Corporation or  
 5 with Older American Act funds shall be presumed  
 6 qualified legal services projects for the purpose of this  
 7 article.

8 (b) Projects meeting the requirements of subdivision  
 9 (a) of Section 6213 but not qualifying under the  
 10 presumption specified in subdivision (a) shall qualify for  
 11 funds under this article if they meet all of the following  
 12 additional criteria:

- 13 (1) They receive cash funds from other sources in the
- 14 amount of at least twenty thousand dollars (\$20,000) per
- 15 year to support free legal representation to indigent
- 16 persons.
- 17 (2) They have demonstrated community support for
- 18 the operation of a viable ongoing program.
- 19 (3) They provide one or both of the following special
- 20 services:

21 (A) The coordination of the recruitment of substantial  
 22 numbers of attorneys in private practice to provide free  
 23 legal representation to indigent persons or to qualified  
 24 legal services projects in California.

25 (B) The provision of legal representation, training, or  
 26 technical assistance on matters concerning special client  
 27 groups, including the elderly, the disabled, juveniles, and  
 28 non-English-speaking groups, or on matters of  
 29 specialized substantive law important to the special  
 30 client groups.

31 6215. (a) Support centers satisfying the qualifications  
 32 specified in subdivision (b) of Section 6213 which were  
 33 operating an office and providing services in California  
 34 on December 31, 1980, shall be presumed to be qualified  
 35 support centers for the purposes of this article.

36 (b) Support centers not qualifying under the  
 37 presumption specified in subdivision (a) may qualify as  
 38 a support center by meeting both of the following  
 39 additional criteria:

- 40 (1) Meeting quality control standards established by

1 the State Bar.  
 2 (2) Being deemed to be of special need by a majority  
 3 of the qualified legal services projects.

4 6216. The State Bar shall distribute all moneys  
 5 received under the program established by this article for  
 6 the provision of civil legal services to indigent persons.  
 7 The funds first shall be distributed 18 months from the  
 8 effective date of this article, or upon such a date, as shall  
 9 be determined by the State Bar, that adequate funds are  
 10 available to initiate the program. Thereafter, the funds  
 11 shall be distributed on an annual basis. All distributions of  
 12 funds shall be made in the following order and in the  
 13 following manner:

14 (a) To pay the actual administrative costs of the  
 15 program, including any costs incurred after the adoption  
 16 of this article and a reasonable reserve therefor.

17 (b) Eighty-five percent of the funds remaining after  
 18 payment of administrative costs allocated pursuant to this  
 19 article shall be distributed to qualified legal services  
 20 projects. Distribution shall be by a pro rata  
 21 county-by-county formula based upon the number of  
 22 persons whose income is 125 percent or less of the current  
 23 poverty threshold per county. For the purposes of this  
 24 section, the source of data identifying the number of  
 25 persons per county shall be the latest available figures  
 26 from the United States Department of Commerce,  
 27 Bureau of the Census. Projects from more than one  
 28 county may pool their funds to operate a joint,  
 29 multicounty legal services project serving each of their  
 30 respective counties.

31 (1) (A) In any county which is served by more than  
 32 one qualified legal services project, the State Bar shall  
 33 distribute funds for the county to those projects which  
 34 apply on a pro rata basis, based upon the amount of their  
 35 total budget expended in the prior year for legal services  
 36 in that county as compared to the total expended in the  
 37 prior year for legal services by all qualified legal services  
 38 projects applying therefor in the county.

39 (B) The State Bar shall reserve 10 percent of the funds  
 40 allocated to the county for distribution to programs

1 meeting the standards of subparagraph (A) of paragraph  
 2 (3) and paragraphs (1) and (2) of subdivision (b) of  
 3 Section 6214 and which perform the services described in  
 4 subparagraph (A) of paragraph (3) of Section 6214 as  
 5 their principal means of delivering legal services. The  
 6 State Bar shall distribute the funds for that county to  
 7 those programs which apply on a pro rata basis, based  
 8 upon the amount of their total budget expended for free  
 9 legal services in that county as compared to the total  
 10 expended for free legal services by all programs meeting  
 11 the standards of subparagraph (A) of paragraph (3) and  
 12 paragraphs (1) and (2) of subdivision (b) of Section 6214  
 13 in that county. The State Bar shall distribute any funds for  
 14 which no program has qualified pursuant hereto, in  
 15 accordance with the provisions of subparagraph (A) of  
 16 paragraph (1) of this subdivision.

17 (2) In any county in which there is no qualified legal  
 18 services projects providing services, the State Bar shall  
 19 reserve for the remainder of the fiscal year for  
 20 distribution the pro rata share of funds as provided for by  
 21 this article. Upon application of a qualified legal services  
 22 project proposing to provide legal services to the  
 23 indigent of the county, the State Bar shall distribute the  
 24 funds to the project. Any funds not so distributed shall be  
 25 added to the funds to be distributed the following year.

26 (c) Fifteen percent of the funds remaining after  
 27 payment of administrative costs allocated for the  
 28 purposes of this article shall be distributed equally by the  
 29 State Bar to qualified support centers which apply for the  
 30 funds. The funds provided to support centers shall be  
 31 used only for the provision of legal services within  
 32 California. Qualified support centers that receive funds  
 33 to provide services to qualified legal services projects  
 34 from sources other than this article, shall submit and shall  
 35 have approved by the State Bar a plan assuring that the  
 36 services funded under this article are in addition to those  
 37 already funded for qualified legal services projects by  
 38 other sources.

39 6217. With respect to the provision of legal assistance  
 40 under this article, each recipient shall ensure all of the

1 following:

2 (a) The maintenance of quality service and  
 3 professional standards.

4 (b) The expenditure of funds received in accordance  
 5 with the provisions of this article.

6 (c) The preservation of the attorney-client privilege  
 7 in any case, and the protection of the integrity of the  
 8 adversary process from any impairment in furnishing  
 9 legal assistance to indigent persons.

10 (d) That no one shall interfere with any attorney  
 11 funded in whole or in part by this article in carrying out  
 12 his or her professional responsibility to his or her client as  
 13 established by the rules of professional responsibility and  
 14 this chapter.

15 6218. All legal services projects and support centers  
 16 receiving funds pursuant to this article shall adopt  
 17 financial eligibility guidelines for indigent persons.

18 (a) Qualified legal services programs shall ensure that  
 19 funds appropriated pursuant to this article shall be used  
 20 solely to defray the costs of providing legal services to  
 21 indigent persons or for such other purposes as set forth in  
 22 this article.

23 (b) Funds received pursuant to this article by support  
 24 centers shall only be used to provide services to qualified  
 25 legal services projects as defined in subdivision (a) of  
 26 Section 6213 which are used pursuant to a plan as  
 27 required by subdivision (c) of Section 6216, or as  
 28 permitted by Section 6219.

29 6219. Qualified legal services projects and support  
 30 centers may use funds provided under this article to  
 31 provide work opportunities with pay, and where feasible,  
 32 scholarships for disadvantaged law students to help  
 33 defray their law school expenses.

34 6220. Attorneys in private practice who are providing  
 35 legal services without charge to indigent persons shall not  
 36 be disqualified from receiving the services of the  
 37 qualified support centers.

38 6221. Qualified legal services projects shall make  
 39 significant efforts to utilize 20 percent of the funds  
 40 allocated under this article for increasing the availability

services to the elderly, the disabled, juveniles, or indigent persons who are members of disadvantaged and underserved groups within their service area.

6222. A recipient of funds allocated pursuant to this article annually shall submit a financial statement to the State Bar, including an audit of the funds approved by a certified public accountant, a report demonstrating the programs on which they were expended, and a report on the recipient's progress in meeting the service expansion requirements of Section 6221.

The Board of Governors of the State Bar shall include a report of receipts of funds under this article, expenditures for administrative costs, and disbursements of the funds, on a county-by-county basis, in the annual report of State Bar receipts and expenditures required pursuant to Section 6145.

6223. No funds allocated by the State Bar pursuant to this article shall be used for any of the following purposes:

- (a) The provision of legal assistance with respect to any fee generating case, except in accordance with guidelines which shall be promulgated by the State Bar.
- (b) The provision of legal assistance with respect to any criminal proceeding.

(c) The provision of legal assistance, except to indigent persons or except to provide support services to qualified legal services projects as defined by this article: 6224. The State Bar shall have the power to determine that an applicant for funding is not qualified to receive funding, to deny future funding, or to terminate existing funding because the recipient is not operating in compliance with the requirements or restrictions of this article.

A denial of an application for funding or for future funding or an action by the State Bar to terminate an existing grant of funds under this article shall not become final until the applicant or recipient has been afforded reasonable notice and an opportunity for a timely and fair hearing. Pending final determination of any hearing held with reference to termination of funding, financial assistance shall be continued at its existing level on a

month-to-month basis. Hearings for denial shall be conducted by an impartial hearing officer whose decision shall be final. The hearing officer shall render a decision no later than 30 days after the conclusion of the hearing. Specific procedures governing the conduct of the hearings of this section shall be determined by the State Bar pursuant to Section 6225.

6225. The Board of Governors of the State Bar shall adopt the regulations and procedures necessary to implement this article and to ensure that the funds allocated herein are utilized to provide civil legal services to indigent persons, especially underserved client groups such as but not limited to the elderly, the disabled, juveniles, and non-English-speaking persons.

In adopting the regulations the Board of Governors shall comply with the following procedures:

(a) The board shall publish a preliminary draft of the regulations and procedures, which shall be distributed, together with notice of the hearings required by subdivision (b), to commercial banking institutions and potential recipients of funds.

(b) The board shall hold at least two public hearings, one in southern California and one in northern California where affected and interested parties shall be afforded an opportunity to present oral and written testimony regarding the proposed regulations and procedures.

6226. The program authorized by this article shall become operative only upon the adoption of a resolution by the Board of Governors of the State Bar stating that regulations have been adopted pursuant to Section 6225 which conform the program to all applicable tax and banking statutes, regulations, and rulings.

6227. Nothing in this article shall create an obligation or pledge of the credit of the State of California or of the State Bar of California. Claims arising by reason of acts done pursuant to this article shall be limited to the moneys generated hereunder.

6228. If any provision of this article or the application thereof to any group or circumstances is held invalid, such invalidity shall not affect the other provisions or

Exhibit 6226

- 1 applications of this article which can be given effect
- 2 without the invalid provision or application, and to this
- 3 end the provisions of this article are severable.

Exhibit 36

IN THE SUPREME COURT OF FLORIDA

CASE NO. 51,182

MATTER OF INTEREST ON	)	
TRUST ACCOUNTS: A PETITION	)	PETITION OF THE FLORIDA BAR
OF THE FLORIDA BAR TO	)	FOUNDATION FOR MODIFICATION
AMEND THE CODE OF	)	OF THE INTEREST ON TRUST
PROFESSIONAL RESPONSIBILITY	)	<u>ACCOUNT PROGRAM</u>
AND THE RULES GOVERNING	)	
THE PRACTICE OF LAW	)	

Pursuant to Article V, Sections 2 and 15, Florida Constitution and Article XIII of the Integration Rule of the Florida Bar, the undersigned twenty-five active members of the Florida Bar, on behalf of the Florida Bar Foundation, move for entry of an Order modifying the Interest on Trust Account Program and amending Article XI, Rule 11.02(4) of the Integration Rule, stating as follows:

INTRODUCTION

1. On March 16, 1978, upon petition by the Board of Governors of the Florida Bar, with the concurrence of the Board of Directors of the Florida Bar Foundation, this Court issued an Opinion establishing the Interest on Trust Account Program. In Re Interest on Trust Accounts, 356 So.2d 799 (Fla. 1978). For the convenience of the Court, a copy of the March 16, 1978 Opinion is attached as Exhibit A.

2. Since the March 16, 1978 Opinion, the Florida Bar Foundation and the Florida Bar have worked diligently in an effort to implement this Program. However, tax issues have arisen which require modification of the Program in order that a tax ruling may be obtained from the Internal Revenue Service

EXHIBIT 4

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states.

that interest earned on client funds for the benefit of the Florida Bar Foundation will not be considered taxable to individual clients. Moreover, since that Opinion, changes have occurred in federal banking laws that will facilitate operation of the Program in the event that the requested modifications are authorized. It is believed that, if these modifications are authorized, the Florida Bar Foundation will be able to successfully implement the Program.

HISTORY OF INTEREST ON TRUST ACCOUNT EFFORT  
AND  
EXISTING RULE

3. The concept underlying the Interest on Trust Account Program is that since a significant amount of an attorney's trust account is composed of client balances that are nominal in amount or held for short periods of time it is impracticable in such cases to establish interest bearing accounts with interest going to the individual clients. The attorney is, of course, prohibited by trust principles from personally benefiting from any interest obtained. Therefore, attorneys have traditionally placed most trust funds in non-interest-bearing commercial bank checking accounts. The Interest on Trust Account Program adopted by the Court would allow collection of interest on such funds to benefit the public good rather than the alternative of leaving the funds idle, benefiting only the banking institutions. Institution of the Program does not affect the ability of the client and the attorney to place client funds in an interest-bearing account for the benefit of the client in those instances where the amount involved and the duration of the deposit make it practicable.

4. In adopting the Program, establishing procedures for its implementation, and specifying uses for the interest derived, Florida became the first jurisdiction within the United States to authorize interest-bearing trust accounts with proceeds to be directed towards public programs to improve the

Exhibit 4 (Page 2)

administration of justice. Such programs are well established in other countries, however, and since adoption of the Florida rule, intense interest has developed throughout the United States. In February, 1979, the Conference of Chief Justices of the 50 state courts adopted a resolution endorsing the Program and recommending its adoption in other states. Over 18 state bar associations as well as the National Center for Professional Discipline, the National Conference of Bar Foundations and the American Bar Association have expressed an active interest in the Program.

5. Generally, the Program, as adopted in the 1978 Opinion, contained the following features:

(a) "The plan would be voluntary, at least until such time as federal law permits the payment of interest on checking accounts or the writing of checks on savings accounts", 356 So.2d at 804.

(b) Attorneys would be permitted to establish three classes of trust accounts:  
(1) interest-bearing accounts for individual clients; (2) an interest-bearing commingled trust account with proceeds going to the Florida Bar Foundation for projects to benefit the administration of justice; and  
(3) the traditional non-interest-bearing commingled trust account. Id. at 805.

(c) Attorneys participating in the Program would obtain their clients' consent to the investment of trust funds by sending to each client a notice providing information concerning the procedures to be utilized and the uses of trust earnings. Unless a

Exhibit 4 (page 3)

specific objection was received from a client, consent was presumed. (Attorneys remained free, of course, to invest client funds in interest-bearing accounts with interest payable to a client whenever practicable). Id. at 807.

(d) Use of the funds obtained was authorized for the following purposes:

- (1) to provide legal aid for the poor;
- (2) to provide for the adequate delivery of legal services to all members of the public;
- (3) to augment the client's security fund with a view toward full reimbursement;
- (4) to fund a more expeditious and efficient grievance mechanism;
- (5) to provide student loans;
- (6) to improve the administration of justice; and
- (7) for such other programs for the benefit of the public as are specifically approved by the Court from time to time. Id. at 811.

(e) Because, at the time of the 1978 Opinion, banking regulations barred the payment of any interest on funds held in commercial bank checking accounts or the immediate withdrawal of funds held in savings accounts, the Program contained a mechanism designed to insure the immediate availability of client funds. The lengthy and somewhat cumbersome procedures included the necessity for transfers from savings to disbursement accounts and a method through which the Foundation would maintain a reserve that would be made available in the event client funds could not be immediately obtained from a trust savings account.

Exhibit 4 (page 4)

6. Since the issuance of the March, 1978 Opinion, the Florida Bar and the Florida Bar Foundation have diligently sought to implement the Program:

(a) To implement the Court's decision with respect to using the Florida Bar Foundation to administer the interest generated by the Program, and pursuant to the Court's instructions, the Charter and Bylaws of the Foundation were modified and the Board of Directors of the Foundation was restructured. The affairs of the Foundation are now managed by a board that includes the Chief Justice of the Supreme Court, two other judicial officers appointed by the Chief Justice, the President of the Florida Bar, and the President of Florida Legal Services, Inc., an organization established by the Florida Bar and the Office of the Governor to assist in the delivery of legal services to the poor. See, Matter of Interest on Trust Accounts, 372 So.2d 67 (Fla. 1979).

(b) A ruling from the Internal Revenue Service was obtained which approved as exempt several of the authorized uses set forth in the Court's 1978 Opinion. The approved uses include: (1) to provide legal aid to the poor; (2) to provide student loans; (3) to improve the administration of justice; and (4) for such other programs for the benefit of the public as are specifically approved by the Court from time to time for exclusively public purposes. Moreover, the Florida Bar Foundation has requested a ruling which is

... Exhibit 4 (pages 5)

still pending for approval of the remaining three purposes outlined in the Court's Opinion.

(c) The Florida Bar and the Florida Bar Foundation sought and obtained modification by the Court of the Trust Account Certificate Provision originally contained in the 1978 Opinion so that the accounting certificate required of participants in the Program is the same as that required generally for all attorneys. Id. at 68.

(d) In seeking to implement the Program, and particularly with regard to the tax issue set forth in detail below, the Florida Bar, and the Florida Bar Foundation have expended many hundreds of hours and many thousands of dollars. The Florida Bar Foundation to date has expended \$44,327.70. The Florida Bar has committed an additional \$20,000.00. This does not include staff services of bar personnel and the pro bono contributions of time made by numerous lawyers. These efforts are now close to fruition.

CHANGES IN BANKING LAW ALLOW  
PROGRAM IMPROVEMENT

7. Since the March, 1978 Opinion of the Court, banking laws have been changed in a manner that allows substantial improvement in the operation of the Program. As the Court evidently anticipated, the United States Congress and the Federal Reserve Board have recently authorized the establishment

∴ Exhibit # (page 6)

of interest-bearing checking accounts well-suited for the requirements of the Program. See, Public Law 96-221, effective December 31, 1980 (Title III, Depository Institutions Deregulation and Monetary Control Act of 1980); 12 U.S.C. § 1832(a); 12 CFR § 217.1(e)(3); Press Release of Federal Reserve Board dated October 20, 1980 (CCH Banking Law Reporter ¶ 98,451; attached as Exhibit B). Such accounts, known as "Negotiable Order of Withdrawal", or "NOW" accounts, may be opened and maintained if the "entire beneficial interest" in the funds in the account is held by (a) one or more individuals or (b) a not-for-profit organization "operated primarily for religious, philanthropic, charitable, educational, or other similar purposes." 12 U.S.C. § 1832(a)(2).

8. There are, therefore, two sets of circumstances in which NOW accounts may not be presently available for use in connection with the Program:

- a) When the law firm/depositor is a for-profit professional association incorporated under Florida law; or
- b) When the beneficial interest in the client funds deposited into the account is held by a for-profit corporation.

9. The first situation should not preclude use of a NOW trust account. The Federal Reserve Board has indicated that a for-profit corporation may open and maintain a NOW account if the corporation is acting solely in a fiduciary capacity for the benefit of individuals or qualifying organizations. See, Press Release of Federal Reserve Board, supra.

10. The second situation is more difficult. The Petitioners are preparing and will submit to the Federal Reserve Board a request for a ruling that all contributions to attorney trust accounts may be deposited in a NOW trust account, irrespective of (a) the status of the client (corporation, trust, partnership, governmental entity, etc.) and (b) whether the trust account is maintained by an individual attorney, partnership of attorneys, or professional association of attorneys.

.. Exhibit 4 (page 7)

11. Accordingly, NOW accounts will be available to smooth the implementation of the Interest on Trust Account Program. Pending an interpretive ruling by the Federal Reserve Board approving the deposit of for-profit corporate clients' funds in NOW trust accounts, Petitioners request that the scope of the Program be confined to trust account deposits by individuals and qualifying not-for-profit corporations. The Program, so limited, can thus be immediately implemented by the simple establishment of a NOW account by each law firm.

THE TAX ISSUE INVOLVED

12. Since the Program involved the investment of client funds for the benefit of another organization, a question existed as to the application of the assignment of income doctrine to the income earned on the trust accounts. This doctrine has been enunciated in several Supreme Court cases from which refinements of the doctrine have been derived. The doctrine was perhaps best described by the Supreme Court in Helvering v. Forst, 311 U.S. 112 (1940), in which it was held that a father who gave interest coupons detachable from his bonds to his son, to whom interest payments were thus made, remained taxable on such interest. In finding the father taxable with respect to the interest paid to the son, the Supreme Court emphasized the control of the source of income and realization through exercise of that control:

"Underlying the reasoning in these cases is the thought that income is 'realized' by the assignor because he, who owns or controls the source of the income, also controls the disposition of that which he could have received himself and diverts the payment from himself to others as a means of procuring the satisfaction of his wants. The taxpayer has equally enjoyed the fruits of his labor or investment and obtained the satisfaction of his desires whether he collects and uses the income to procure those satisfactions, or whether he disposes of his right to collect it as a means of procuring them." Id. at 116.

13. If the assignment of income doctrine were to be found to apply to the Program, the effect of such a determination

Exhibit 4C PAGE 5

would be that a client would be required to include in his gross income, for federal income tax purposes, interest income which is not, and cannot, be made available to that client. An unfavorable ruling by the Internal Revenue Service would therefore impose a tax reporting requirement inconsistent with this Court's finding that accounting complexities preclude the client from getting the income in the first place. It would be unjustified for the lawyer and the client to devote the resources to ascertain each client's share of interest income, and the same consideration would make it difficult for the Internal Revenue Service to enforce such a reporting requirement. The uncertainty caused by the lack of advance assurance of compliance with the tax laws precluded implementation of the Program.

14. In order to obtain a resolution of this issue prior to the implementation of the Program, the Florida Bar Foundation obtained the services of tax counsel, Cohen and Uretz of Washington, D.C. for the purpose of obtaining a ruling from the Internal Revenue Service with respect to the application of the assignment of income doctrine to the Program. Because of the pro bono aspects of the Program, Cohen and Uretz have provided their services at approximately 50% of their usual fee arrangement.

15. A ruling request was filed with the Internal Revenue Service on behalf of the Florida Bar Foundation on September 26, 1979. In this ruling request, the Florida Bar Foundation requested a ruling from the Internal Revenue Service that interest paid to the Florida Bar Foundation on trust savings accounts would not be included in the gross income of the clients whose funds were on deposit in the trust account. A copy of the ruling request is attached as Exhibit G.

PROCEEDINGS BEFORE THE INTERNAL REVENUE SERVICE

16. Because of the significant potential for public benefit offered by the Program, a number of public officials wrote to the Treasury Department and the Internal Revenue

Exhibit 4 (PAGE 13)

Service to express support for the Program and to request favorable consideration of the Foundation's ruling request if the tax law could be properly interpreted to allow implementation of the Program. Letters from Governor Graham, Senator Chiles, and the Director of the National Center for State Courts are attached as Exhibits D - F. Many other persons also assisted.

17. A conference was held with representatives of the Internal Revenue Service on March 27, 1980. In a letter dated August 19, 1980, Assistant Secretary for Tax Policy, Donald Lubick indicated that the Treasury Department hoped that a favorable ruling could be issued without setting a bad precedent in other areas. The letter also indicated that if an administrative solution was not forthcoming, the Treasury Department would give favorable consideration to a legislative solution. Assistant Secretary Lubick requested, however, that legislation be delayed until the outcome of the administrative consideration.

18. Subsequently, on October 2, 1980, representatives of the Florida Bar Foundation and tax counsel met with then Commissioner of the Internal Revenue Service Jerome Kurtz and Assistant Commissioner (Technical) Gerald Portney. Mr. Kurtz recognized the potential benefits of the Program but expressed uncertainty as to whether a favorable ruling would prove to be a bad precedent in other areas. Mr. Portney also was concerned about the application of the assignment of income doctrine.

19. On November 25, 1980, the Internal Revenue Service advised tax counsel that a preliminary decision had been made that the Program as presently constituted resulted in an assignment of income and that an unfavorable ruling would be issued. The Internal Revenue Service was concerned about the portion of the 1978 Opinion which permitted the client to determine that funds that are nominal in amount or to be held for short periods of time would not go into an interest-bearing account to benefit the Foundation but rather would remain in a traditional non-interest-bearing account. The Internal Revenue

Exhibit 4 (Page 10)

REQUESTED MODIFICATION OF INTEGRATION RULE

22. As a result of the changes in federal banking law and in order to reconcile the tax issue presented, the Court is requested to modify the procedures outlined in the Opinion establishing the Interest on Trust Account Program and the Integration Rule in the following respects:

(a) A modification in the procedures outlined in the 1978 Opinion is requested. In place of paragraph 6, on page 15 of the Opinion (356 So.2d at 807) the following language is requested:

6. Interest earned on trust accounts, as defined in paragraph 5 above, containing client balances that are nominal in amount or held for short periods of time shall be paid to the Florida Bar Foundation, Inc., for its charitable purposes. Maintenance of such trust account balances in non-interest-bearing trust accounts will not be permitted. Attorneys will remain free to exercise their discretion to arrange special investments not limited to savings accounts for advances not described in the preceding sentences for the funds of their clients when appropriate;

(b) Amendment of Section 11.02(4)(d) is

~~requested so that the provision would read as~~  
follows:

(d) Trust Accounts. A member of the Florida Bar, who in the course of the professional practice of law receives or disburses trust funds, shall create and maintain an interest-bearing demand trust account and shall deposit therein all client funds to the extent permitted by applicable banking laws, that are nominal in amount or are on deposit for a short period of time. The attorney shall comply with the following provisions:

(i) The interest bearing demand trust account may be established with any bank or savings and loan association authorized by federal or state law to do business in Florida and insured by the Federal Deposit

Exhibit 4 (page 12)

Service felt that the ability of the client to deprive someone (i.e., the Foundation) of income was the equivalent of a right to control the disposition of that income. Since a client could prevent the investment of account balances which were small in amount or short in duration in trust accounts bearing interest payable to the Florida Bar Foundation, he had the ability to prevent the Foundation from receiving income from the investment of his trust funds. In addition, the Internal Revenue Service expressed uncertainty as to whether the 1978 Opinion could be interpreted to hold that the client retained the right to direct the lawyer to invest account balances that are nominal in amount or held for short periods of time in interest-bearing accounts for the benefit of the client.

20. The Internal Revenue Service indicated, however, that a favorable ruling would be issued if the Program were clarified to state explicitly that interest earned on trust accounts containing client balances that are small in amount or to be held for short periods of time must be payable to the Florida Bar Foundation and that such trust account balance may not be invested in non-interest-bearing trust accounts. The Internal Revenue Service expressed the view that, under such circumstances, the discretionary aspect of the Program would be eliminated, and the assignment of income doctrine therefore would not be applicable.

21. Following this meeting, a letter was submitted by tax counsel to the Internal Revenue Service to confirm the type of modifications to the Program which would be required in order to obtain a favorable ruling from the Internal Revenue Service. Although no absolute assurances can be made, the modifications to the Integration Rule requested below are in accordance with the guidelines established by the Internal Revenue Service for issuing a favorable ruling. Copies of correspondence between the Counsel and the Service are attached as Exhibits C and D.

Exhibit 4 (PAGE 11)

Insurance Corporation or the Federal Savings and Loan Insurance Corporation.

(ii) The rate of interest payable on any interest-bearing demand trust account shall not be less than the rate paid by the depository institution to regular, non-attorney depositors. Higher rates offered by the institution to customers whose deposits exceed certain time or quantity minima, such as those offered in the form of certificates of deposit, may be obtained by a lawyer or law firm so long as there is no impairment of the right to withdraw or transfer principal immediately (except as accounts generally may be subject to statutory notification requirements), even though interest may be sacrificed thereby.

(iii) The depository institution shall be directed:

(A) to remit interest or dividends, as the case may be, on the average monthly balance in the account, at least quarterly, to the Florida Bar Foundation, Inc;

(B) to transmit with each remittance to the Foundation a statement showing the name of the lawyer or law firm for whom the remittance is sent and the rate of interest applied; and

(C) to transmit to the depositing lawyer or law firm at the same time a report showing the amount paid to the Foundation, the rate of interest applied, the average account balance for each month of the period for which the report is made, and any remittances to the Foundation made during that period pursuant to subparagraph (iii)(B).

(iv) In those instances where the amount of the client balance or the duration of deposit render it financially practicable, the attorney may exercise discretion to arrange special investments, not limited to savings accounts, for deposit of client funds with any interest obtained payable to the client.

(v) In the event that any client asserts a claim against an attorney based upon such attorney's determination to place client advances in the interest bearing demand trust account because such balance is nominal in amount or held for a short period of time,

Exhibit 4 (page 13)

the Foundation shall, upon written request by such attorney, review such claim and either:

(A) Approve such claim (if such balances are found not to be nominal in amount or short in duration) and remit directly to the claimant any sum of interest remitted to the Foundation on account of such funds; or

(B) Reject such claim (if such balances are found to be nominal in amount or short in duration) and advise the claimant in writing of the grounds therefor. In the event of any subsequent litigation involving such a claim, the Foundation shall interplead any such sum of interest and shall assume the defense of the action.

A copy of the current rule showing the requested modifications and the language that would be eliminated by the requested changes is attached as Exhibit J.

#### EXPLANATION OF REQUESTED MODIFICATIONS

23. The requested modifications vastly simplify the existing Program. Utilization of the demand accounts, now permitted by banking laws, eliminates the need for the complicated mechanism, contained within the existing rule, designed to insure client funds would be available upon demand. The need for transfer of funds from a savings to a disbursement account, and the resulting inconvenience to the lawyer, is also eliminated.

24. The modifications to the Program relate only to client funds that are small in amount or are on deposit for a short period of time. The modification clarifying that such advances must be deposited in commingled accounts is intended to make clear that a client cannot require deposit of such advances in a separate non-interest-bearing account. That modification is in conformity with the 1978 Opinion's conclusion that interest on such funds is not now available to individual clients, and for practical reasons cannot be made available to

Exhibit 4 (page 14)

them. As a result, such modification would not deprive the client of any right to receive interest which he presently possesses. The modification eliminating the option of depositing advances that are small in amount or short in duration in non-interest-bearing accounts would eliminate that element of control over such funds, i.e., whether such funds are to be made productive of income for the Foundation or not productive at all, which the Internal Revenue Service considers sufficient to cause an assignment of income by the client.

25. Elimination of the ability of the client to require that funds be placed in a non-interest bearing account rather than allow the funds to be placed in the commingled account with interest payable to the Foundation insures that the client will remain free of any tax liability. Elimination of the client veto also obviates the need for the cumbersome and expensive notice provision. Attorneys remain free to invest client funds in interest-bearing accounts with interest payable to a client whenever practicable.

26. Under the traditional practice, prior to the adoption of the Interest on Trust Account Program, discretion was exercised to place client funds into the non-interest bearing commingled trust account or into a special investment with interest payable to the client. The determination has been traditionally made based upon the amount of money involved and the duration of the deposit and no instance is known where a client has made a claim upon the lawyer based upon that exercise of judgment.

Under the Program, if modified as requested, the lawyer would continue to place client funds that are nominal in amount or on deposit for short periods of time in a commingled trust account with no interest payable to the client. The only difference from existing practice is that interest would be earned on the entire trust account balance, composed of these numerous commingled client balances, with such interest payable to the Foundation.

Exhibit 4 (page 15)

Since the same standard is involved, with or without the Program, it is not expected that implementation will result in any increase of instances of client-lawyer dispute, particularly since the lawyer will be acting as required by Order of this Court. Nevertheless, if such a dispute should arise, it is reasonable to expect the Foundation to assist in resolution of the dispute and to bear the expense of compliance with the Program. For that reason, the requested modifications include such provision.

REQUEST FOR EXPEDITED CONSIDERATION  
AND  
SUGGESTED PROCEDURE

27. In view of the loss of public benefits occasioned by any delay in implementation, as well as the need for resolution of the tax issue since the Internal Revenue Service has indicated that it is now prepared to rule favorably if the modifications are adopted, the Court is respectfully requested to expedite consideration of this matter. The Petitioners suggest that interested persons be allowed 30 days from the date of this Petition within which to file written submissions with the Court, allowing petitioners 10 days to respond, with oral argument set as soon thereafter as practicable.

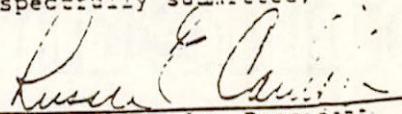
CONCLUSION

28. Implementation of this significant and innovative Program offers immense potential to benefit the public with no loss of protection to clients, and little inconvenience to members of the Bar. Lawyers have a professional obligation to assist in improving the administration of justice, and to provide legal services for those unable to pay for such services. See Canons 2 and 8, Code of Professional Responsibility. As a result of changes in the banking law and the prospect of a favorable tax determination following many

Exhibit 4 (page 16)

months of lengthy deliberations, successful implementation of the Program is imminent. The Court is urged to adopt the requested modifications.

Respectfully submitted,



Russell Carlisle, President  
Florida Bar Foundation  
On behalf of the Florida Bar  
Foundation and the following  
active members of the Florida  
Bar:

W. George Allen  
Peubin O'D Askew  
John K. Aurell  
Martha Barnett  
Drake M. Batchelder  
Irwin J. Block  
John L. Burns  
Rowlett W. Bryant  
Marshall R. Cassidy  
Julian D. Clarkson  
Edwin C. Gluster  
James E. Cobbe  
LeRoy Collins  
Talbot D'Alemberte  
Barry R. Davidson  
Darrey A. Davis  
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Royce F. Fzell III  
John M. Farrell  
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John Edward Smith  
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Sylvia W. Walkolt  
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Stephen N. Zack

Exhibit 4 (page 17)

# Internal Revenue bulletin

## Highlights of this issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

### INCOME TAX

#### Rev. Rul. 81-206, page 5.

**Obsoleted rulings; discharges of indebtedness; section 38 property.** For discharges of indebtedness that occur after December 31, 1980, the Bankruptcy Tax Act of 1980, makes obsolete Rev. Ruls. 72-248 and 74-184, relating to the recomputation of investment credit to reflect the reduction in the basis of section 38 property. Rev. Ruls. 72-248 and 74-184 obsoleted.

#### Rev. Rul. 81-207, page 6.

**Losses; embezzled funds; cost of goods sold.** A taxpayer who discovered that an employee had embezzled funds by writing checks for fictitious purchases of raw materials, the cost of which was included in the cost of goods sold for a number of years, may not currently deduct an embezzlement loss under section 165(a) of the Code.

#### Rev. Rul. 81-208, page 7.

**Completed contract method; long-term; crating and shipping.** Crating and shipping expenses of a taxpayer utilizing the completed contract method of accounting are not currently deductible as "other distribution expenses," but are "indirect costs" and must be allocated to the long-term contracts to which they are attributable.

#### Rev. Rul. 81-209, page 5.

**Interest; attorney's trust account.** Interest earned on clients' nominal and short-term advances deposited in an attorney's trust account and paid over to a bar foundation, pursuant to a program established by the Supreme Court of State X, is not includible in the gross incomes of the clients.

#### Rev. Proc. 81-40, page 24.

**Accounting period; change; Form 1128.** Form 1128, Application for Change in Accounting Period, filed by an individual and trustee or co-trustee, is to be filed at the Internal Revenue Service Center where the taxpayer's income tax return is filed on or before the 15th day of the second calendar month following the close of the short period for which a federal income tax return is required to effect the change of accounting period. Rev. Procs. 66-50 and 68-41 modified.

#### Rev. Proc. 81-41, page 24.

**Controlled corporation; stock and securities distribution; revised checklist for ruling request.** A revised checklist sets forth the information to be included in a request for a ruling under section 355 of the Code with respect to distributions of stock and securities of a controlled corporation. Rev. Proc. 75-35 superseded.

#### Rev. Proc. 81-42, page 30.

**Distribution in partial liquidation; revised checklist for ruling request.** A revised checklist sets forth the information to be included in a request for a ruling under section 346 of the Code with respect to distributions in partial liquidation. Rev. Proc. 73-36 superseded.

#### Notice 81-12, page 12.

The applicable interest rate on the amount of additional tax attributable to any nonqualified withdrawals from a capital construction fund established under section 607 of the Merchant Marine Act is 12.41 percent for withdrawals made in taxable years beginning in 1981.

#### Announcement 81-136, page 36.

Various areas of the State of Kansas have been declared disaster areas in which losses qualify for the special tax treatment under section 165(h) of the Code.

(Continued on page 4)

Finding Lists begin on page 40.

Announcement of Suspensions and Resignation on page 37.

Announcement of Notice of Proposed Rulemaking on page 38.

Department of the Treasury  
Internal Revenue Service

earned on the commingled advances. Furthermore, under the program, clients cannot compel attorneys to invest the advances on the clients' behalf.

#### HOLDING

Under the unique facts described herein, interest earned on clients' nominal and short-term advances and paid over to the bar foundation pursuant to the program established by the Supreme Court of X is not includible in the gross incomes of the clients.

#### Section 108.—Income From Discharge of Indebtedness

26 CFR 1.108(a)-1: Income from discharge of indebtedness.

Under the Bankruptcy Tax Act of 1980, a reduction in the basis of section 38 property pursuant to sections 108 and 1017 of the Code shall not be treated as a disposition of the section 38 property. Rev. Rul. 72-248, and Rev. Rul. 74-184, are obsolete for discharges of indebtedness that occur after December 31, 1980. See Rev. Rul. 81-206, page 5.

#### Section 165.—Losses

26 CFR 1.165-8: Theft losses.

Losses; embezzled funds; cost of goods sold. A taxpayer who discovered that an employee had embezzled funds by writing checks for fictitious purchases of raw materials, the cost of which was included in the cost of goods sold for a number of years, may not currently deduct an embezzlement loss under section 165(a) of the Code.

Rev. Rul. 81-207

#### ISSUE

Under the circumstances described below, may a taxpayer currently deduct an embezzlement loss under the provisions of section 165(a) of the Internal Revenue Code?

#### FACTS

In 1980 the taxpayer, a manufacturing corporation, discovered that between 1974 and 1977 an employee had embezzled 70,000x dollars by writing checks for fictitious purchases of raw materials. The 70,000x dollars were recorded on the taxpayer's books in a purchase account and were thus

included in the taxpayer's cost of goods sold for each year the funds were embezzled. This accounting treatment resulted in an increase in the cost of goods sold and a commensurate decrease in the taxpayer's taxable income for each of the years in which the embezzlement took place.

On its federal income tax return for 1980, the taxpayer claimed a deduction under section 165(a) of the Code for the full amount of the embezzlement loss. In 1981, the Internal Revenue Service examined the taxpayer's 1980 federal income tax return. By this time, the period of limitations had expired for the taxable years 1974 through 1977. The Service disallowed the embezzlement loss deduction claimed in 1980 because the taxpayer had received a tax benefit for the embezzlement loss in each of the taxable years 1974 through 1977 due to the erroneous overstatement of the cost of goods sold, which reduced the taxpayer's taxable income by the amount of the overstatement for those taxable years.

The taxpayer, relying upon the decisions of the United States Tax Court in the cases of *B. C. Cook & Sons, Inc. v. Commissioner*, 59 T.C. 516 (1972), ("*Cook I*"); and *B. C. Cook & Sons, Inc. v. Commissioner*, 65 T.C. 422 (1975), ("*Cook II*"), nonacq., 1977-1 C.B. 2, *aff'd per curiam*, 584 F.2d 53 (5th Cir. 1978), claims that it is entitled to a theft loss deduction under section 165(a) of the Code in 1980, even though the amount embezzled was previously reflected in its cost of goods sold, which resulted in a tax benefit.

#### LAW AND ANALYSIS

Section 165(a) of the Code provides that there shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

Section 165(e) of the Code and section 1.165-8 of the Income Tax Regulations provide that a loss arising from a theft shall be treated under section 165(a) as sustained during the taxable year in which the taxpayer discovers the loss.

Section 1.165-8(d) of the regulations provides that for purposes of section 1.165-8, the term "theft" shall be

deemed to include, but shall not necessarily be limited to, larceny, embezzlement, and robbery.

In *Cook I* the Tax Court held that the taxpayer was entitled to an embezzlement loss deduction in the taxable year the loss was discovered. In that case the taxpayer's bookkeeper embezzled funds by writing checks for fictitious purchases that were reflected on the taxpayer's books as additional purchases. The embezzled amounts were thereby reflected in the taxpayer's cost of goods sold, which resulted in the reduction of the taxpayer's income by a like amount. Thus, the taxpayer twice reduced its taxable income by the amount of the embezzled funds.

In *Cook II* the Tax Court held that an overstatement of the cost of goods sold was not a deduction for purposes of section 1312(2) of the Code, and, therefore, the determination in *Cook I* did not allow a deduction or credit twice and there was no error that could be corrected under section 1311. The result of *Cook I* and *Cook II* is that an embezzlement loss was allowed as a deduction under section 165(a) in the year the embezzlement was discovered and was also allowed as an adjustment to the cost of goods sold in the years the embezzlement occurred.

The Internal Revenue Service will not follow the decisions of the United States Tax Court and the United States Court of Appeals in *Cook I* and *Cook II*.

The holding of *Cook I* conflicts with the principle set forth by the Tax Court in *Unvert v. Commissioner*, 72 T.C. 807 at 814 (1979), that taxpayers have a duty of consistency that "precludes a taxpayer who has received a tax benefit due to his treatment of an item in a year barred by the statute of limitations from claiming that the original treatment was incorrect and thus obtaining a tax advantage in a later year." Based on this principle of consistency the Service can disallow the theft loss in the year of discovery in cases where the taxpayer has received a prior tax benefit.

#### HOLDING

A taxpayer may not currently deduct an embezzlement loss under the provisions of section 165(a) of the

## Part 1. Rulings and Decisions Under the Internal Revenue Code of 1954

### Section 47.—Certain Dispositions, Etc., Of Section 38 Property

26 CFR 1.47-2: "Disposition" and "cessation".  
(Also Sections 108, 1017; 1.108(a)-1, 1.1017-1.)

**Obsoleted rulings; discharges of indebtedness; section 38 property.** For discharges of indebtedness that occur after December 31, 1980, the Bankruptcy Tax Act of 1980, makes obsolete Rev. Ruls. 72-248 and 74-184, relating to the recomputation of investment credit to reflect the reduction in the basis of section 38 property. Rev. Ruls. 72-248 and 74-184 obsoleted.

Rev. Rul. 81-206

#### ISSUE

What is the effect of the enactment of the Bankruptcy Tax Act of 1980, Pub. L. 96-589, 1980-2 C.B. 607 ("Bankruptcy Act") on Rev. Rul. 72-248, 1972-1 C.B. 16, and Rev. Rul. 74-184, 1974-1 C.B. 8?

#### LAW AND HOLDING

In Rev. Rul. 74-184, which amplified Rev. Rul. 72-248, the taxpayer incurred bond indebtedness for purposes other than the acquisition of section 38 property. Later, the taxpayer reacquired the bonds at a gain and excluded the gain from its gross income and decreased the basis of certain of its section 38 property pursuant to sections 108 and 1017 of the Internal Revenue Code. The revenue ruling holds that the investment credit must be recomputed to reflect the reduction in the basis of the section 38 property, and the entire amount of the reduction in the investment credit will increase the taxpayer's federal income tax liability for the taxable year for which the basis of the section 38 property was reduced.

Section 1017(c)(2) of the Code, as enacted by the Bankruptcy Act, provides that a reduction in basis under this section shall not be treated as a disposition. In discussing this amendment to section 1017, the Senate Finance Committee states:

This rule overturns the position taken by the Internal Revenue Service in Rev. Rul. 74-184, supra, in the case of a solvent debtor making an election under sections 108 and 1017 of the Code (as amended by the bill), and precludes exten-

sion of that position to bankrupt or insolvent debtors.

S. Rep. No. 96-1055, 96th Cong., 2d Sess. 20 (1980), 1980-2 C.B. 620, 630. The Committee also states that a purchase price adjustment continues to constitute an adjustment for purposes of the investment credit rules of the Code.

The debt discharge rules of the Bankruptcy Act, in the case of discharges of indebtedness outside of bankruptcy cases, apply to any discharge of indebtedness occurring after December 31, 1980.

#### EFFECT ON OTHER REVENUE RULING

Rev. Rul. 72-248 and Rev. Rul. 74-184 are obsolete for discharges of indebtedness that occur after December 31, 1980.

### Section 61.—Gross Income Defined

26 CFR 1.61-7: Interest.

**Interest; attorney's trust account.** Interest earned on clients' nominal and short-term advances deposited in an attorney's trust account and paid over to a bar foundation, pursuant to a program established by the Supreme Court of State X, is not includible in the gross incomes of the clients.

Rev. Rul. 81-209

#### ISSUE

Whether interest earned on client advances deposited in "trust accounts" under the circumstances described below is includible in the gross income of the clients.

#### FACTS

Attorneys in state X who are retained to render legal service must place in trust accounts monetary advances received in the ordinary course of their business. In many cases these advances are too small in amount and are on deposit for too short a time to permit, as a practical matter, deposit of funds in separate accounts for each client, or deposit in a commingled ac-

count with interest allocated to each client. As a consequence, the long standing practice of attorneys in state X is to deposit these small and short-term advances in commingled noninterest bearing checking accounts.

In 1981 the Supreme Court of state X reviewed this practice regarding client advances as a matter within its original jurisdiction regarding the discipline and practice of attorneys. The court concluded that for practical reasons interest could not be made available to the clients on advances that were nominal and held for short duration, and continued the practice of allowing attorneys to deposit these advances in noninterest bearing checking accounts. However, the court also concluded that such funds could be productive of income for charitable purposes, and could be invested without violating the fiduciary relationship between attorney and client. Accordingly, the court established a program whereby an attorney could elect to commingle the nominal and short-term advances of all clients in an interest bearing trust account instead of a noninterest bearing checking account. Interest earned on amounts deposited in these trust accounts will be paid to the bar foundation of state X, a non-profit charitable organization described in section 501(c)(3) of the Internal Revenue Code.

The rights of the clients with respect to these advances will not be changed by the program; and no client may individually elect whether to participate in the program. If the attorney elects to participate in the program, the attorney must do so with respect to nominal and short-term advances of all clients. As with advances deposited in noninterest bearing checking accounts, advances deposited under the program continue to be readily available to attorneys for disbursement on behalf of clients. Under the program, all these disbursements for clients are in fact paid out of these trust accounts. The program bars clients from receiving the benefit of any interest earned on the commingled advances; and, because of their fiduciary responsibility to their clients with respect to any advances, it is illegal for the attorneys to receive any benefit from the interest

A Significant New Revenue Source for Legal Services Begins: Interest on Trust Accounts.

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