

QUEENSLAND FIDELITY COMPENSATION 1990– 2004: THE END OF THE MONEY TREE

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I INTRODUCTION

The history of fidelity compensation in the Australian States and Territories is one of noble purpose gradually subverted by financial largesse. The recognition in the early 1930s that some lawyers' thefts of their clients' funds had the potential to seriously damage not only public confidence in lawyers, but also their relative independence from government control, compelled the profession to establish fidelity compensation schemes for clients around the country.¹ Queensland was no exception, establishing its fund in 1931, in response to the McCowan defalcations.² Gradually, however, this commendable purpose was suffocated by the increasingly large amounts of money available to the fidelity funds from their major income source — the interest on clients' trust accounts — money which often was not needed for fidelity compensation but which could not be seen to simply languish in bank accounts, apparently doing nothing.

Legal aid and Law Society expenses soaked up the excess funds for several decades until eventually, and in common with both Victoria and New South Wales, the 1990s produced its crop of recalcitrant solicitors who managed to elude scrutiny for just long enough to steal prodigious sums of money from large numbers of trusting, hapless clients. 'Flash' Harry Smith,³ of Gold Coast ill-repute, took \$6 million off his Catholic clientele⁴ before the whistle blew and suddenly, the fidelity fund was empty. The implications of that single deficiency, based on an inherent financial instability within the Queensland fund structure, laid some of the foundations for the most radical reform in the history of the Queensland profession. The story of fidelity funding in Queensland since 1990 is a story of dependence, comfort and eventual dismay, contributing to the effective demise of legal self-regulation.

II COMPLACENT ADMINISTRATION

The early 1990s were characterised by a relative calm within the Queensland Legal Practitioners Fidelity Guarantee Fund (LPFGF — 'the fund'): a period

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¹ Adrian H Evans, *The Development and Control of The Solicitors Guarantee Fund (Victoria) and Its Ethical Implications for the Legal Profession* (LLM Thesis, Monash University, 1997).

² *Law Society Amendment Act 1930* (Qld). Mark Lunney provides a thorough history of the circumstances of these early years in 'The Solicitor and the Bookmaker — The Foundation of the Solicitors Compensation Fund' (1996) 26 *Queensland Law Society Journal* 35–48.

³ 'Flash Harry Smith Made to Pay Piper', *The Courier Mail* (Brisbane), 23 February 2001, 2.

⁴ *Ibid.*

of significant inflow of clients' interest and relatively low claims experience. Complacency had emerged in relation to the fund within the Queensland Law Society ('the Law Society'). This extract from a 1997 study of Australian fidelity arrangements, describes the situation:

The Queensland [LPFGF] is perhaps closest to Victoria in terms of potential instability [C]lients' interest is the major income source ... current assets ... are comparatively small, the [Queensland Law Society] extracts a considerable amount from the fund for its own purposes prior to claims payments, contingent claims of a locally significant amount are waiting in the wings and the reserve ceiling is relatively low.

Although a very low claims experience does not suggest imminent disaster, the LPFGF accounts do not, it is suggested, fully reflect the narrow margins within which the fund operates. The LPFGF is not automatically in a position to call upon residuary balance interest — collected in the General Trust Accounts Contribution Fund [GTACF] — should a run on claims occur, because this latter source is administered solely as a funding vehicle for legal aid and other public purposes. The GTACF has no provision for supplementary defalcation compensation to be paid out through the LPFGF.

Unfortunately, there appears to be little acknowledgment that there are significant conflicts of interest ... in the Queensland structure. Whilst it is understandable that low claims levels result in little or no public pressure for debate ... the [Law Society] has been exposed publicly both to the possibility of paying clients' interest to clients and to the doubtful nature of its expense sharing arrangements with the LPFGF In 1991–92 the Queensland Parliamentary Public Accounts Committee recommended that [Queensland Law Society] administration of interest earned on solicitors' trust accounts should cease.⁵

The Public Accounts Committee report referred to here faded into obscurity because there was not then any defalcation crisis in Queensland, though the seeds of disaster had been sown. The extraction of money for legal aid and for various Law Society activities as priority expenditures, as well as the decision not to assess contingent liabilities (that is, claims that were likely to crystallise) as specific liabilities in the main accounts, meant that fidelity compensation in Queensland was being set up to fail at some point in the future. The first pressures did not take all that long to appear.

⁵ Evans, above n 1, 148–349, citing Parliamentary Public Accounts Committee, Parliament of Queensland, *Management of Funds Earned on Solicitors Trust Accounts Report No 17* (1991) Recommendation 1. See also 'Probe into Law Society', *The Courier Mail* (Brisbane), 13 July 1991. A short analysis of the state of Queensland fidelity mechanisms as at 1994–95 may be found at Evans, above n 1, Appendix H – 'Selective Comparison of Australian State And Territory Fidelity Funds', 392–393. The ability of new software to calculate interest on bank balances at very low levels was a progressive development throughout the 1990's. As early as 1991, the Queensland Parliamentary Public Accounts Committee was also alert to this possibility. See Evans, above n 1, 197, citing the abovementioned Committee report at [3.4] 21.

III EXCLUSION OF CLAIMS ARISING FROM CONTRIBUTORY MORTGAGES

In 1996, Law Society President Julie-Anne Schafer identified the vulnerability of the fund to claims from private mortgage lending, that is, the accumulation of many small lenders' funds into larger loans, which were then lent to property developers on a contributory mortgage basis. Contributory mortgage lending was prone to theft because large numbers of small, inexperienced lenders tended to be easier to deceive by practitioners who provided false documentation and relied on trust to dissuade those lenders' enquiries as to the identity of borrowers or the adequacy of security. Ms Schafer commented that the fund balance was 'modest' while private mortgage lending was 'very large' and hinted that 'outside regulation' might be on the cards if the issue was not taken in hand.⁶ A then obedient Attorney-General legislated to remove from fidelity compensation all mortgage lending other than direct mortgages (that is, non-contributory mortgages) as from the 16 May 1996,⁷ but this did nothing to compensate for declining interest rates and therefore, lower income to the fund.⁸ Claims were also steadily rising⁹ and although there was not yet any single disastrous claim, the squeeze was starting to hurt. Although both government (through its continued diversion of interest on clients' trust balances to finance Queensland legal aid) and the Law Society (through its priority annual extraction of a large amount for Law Society administrative and other expenses)¹⁰ could see that the fund was no longer a bottomless trough, neither was disposed to vary their respective extractions from the fund.

Government, in common with most Australian jurisdictions, considered that the funding of legal aid was far more important than fidelity funding and the Law Society was loath to cut back its internal operating subsidies. Accordingly, the Law Society Council ('Council') resolved in November 1996 to restructure the fund so that, contrary to the intent of the 1933 founders (to cover all thefts no matter who caused them),¹¹ the profession would essentially cease to cover all losses to clients and, in turn, require each firm to self-insure for their own losses.¹² To its credit, the Law Society was nevertheless clear that, in respect of claims that were admitted, it would continue to pay them in full, notwithstanding

⁶ Julie-Anne Schafer, 'Letters to the Editor' (March 1996) *Proctor* 3. The Law Society nevertheless kept levies on practitioners for the following year at \$300 per practitioner. (May 1996, *Proctor* 6)

⁷ *Queensland Law Society Legislation Amendment Act 1996* (Qld) s 4.

⁸ Hugh Grant, 'President's Page: Fidelity Fund Premiums Restructured' (December 1996) *Proctor* 3.

⁹ See *Queensland Law Society Incorporated Annual Report 1996-97*, 56 and also *Queensland Law Society Incorporated Annual Report 1997-98*, 76.

¹⁰ These extractions were described as 'shared expenditure'. The Annual Accounts of the Queensland Law Society typically included this description of the practice: '[Administrative expenses] includes contributions to the Queensland Law Society Incorporated for shared expenditure — Rule 116(3)(e). These contributions recognise the managerial and administrative tasks performed by Society staff on behalf of the Fund. The monetary level of the contributions are based on a detailed time survey conducted for a period of time by Society staff.' See *Queensland Law Society Incorporated Annual Report 1997-98*, 81. It is possible that Queensland Law Society dependence on this effective operational subsidy had the effect of vesting an interest in the overall fund structure, such that the *status quo* became more important than the need to adjust to the rapidly changing claims environment.

¹¹ Lunney, above n 2.

¹² Grant, above n 8.

the option to limit payment in any one claim to \$60,000 under the existing fund rules.¹³

The combative sentiments of the Council (at least) were well summed up in this extract from the Law Society's 1997–98 *Annual Report*:

Council is of the view that there is no moral or other justification for practitioners to support a Fidelity Fund under which members are required to indemnify the criminal activities of their colleagues The fund has been allowed to run down by government for too long to fund legal aid If government and the community requires such a fund then it must be by allowing it to increase to a proper level and/or must be on a user pays basis Practitioners run businesses ... [and] ... obligations imposed on practitioners to contribute to the Fund undermines viability of legal practices.¹⁴

Basic dissatisfaction with an obligation to finance fidelity compensation was, however, to become outright resentment. The Law Society was increasingly forced to lend several million dollars to the fund to keep it in the black,¹⁵ while the Law Society President, Paul McCafferty was arguing, not without some merit, that

since the establishment of the fund in 1930 the landscape has changed. The concept of vicarious criminal liability has little currency throughout the civilised world; the professional environment is no longer the 'club' scene of 50 years ago when practitioners knew, or knew of, each other, thus providing a moral form of peer-group self control not existent in a large and diversified industry.¹⁶

While it is plausible that 'peer group self control' existed in 1930s legal practice across Australia, the relative ineffectiveness of this culture in dealing with theft was also the reason for the nationwide adoption of fidelity compensation mechanisms at that time. The continuing need for formal compensation arrangements in fact begs the question as to the viability of 'self control'. Certainly, whether the Law Society knew it or not, fidelity compensation schemes are internationally regarded as a minimum professional responsibility, even if they do involve 'vicarious criminal liability'.¹⁷ Unwittingly or not, Mr McCafferty was describing the decline of the 'professional' mystique (insofar as preventing thefts is concerned) and

¹³ Ibid, referring to *Queensland Law Society Act 1952* (Qld) s 24.

¹⁴ *Annual Report 1997–98*, Queensland Law Society, 5.

¹⁵ 'Council News' (October 1998) *Proctor*, 10. The Attorney-General was reported to have agreed on 25 August 1998 with the request of the Law Society to allow it to lend up to \$2.5million to the fund.

¹⁶ Paul McCafferty, 'President's Page: Fidelity Fund — A Vicarious Concept?' (September 1998) *Proctor* 3.

¹⁷ Adrian Evans, 'Summary of Results: International Survey of Client Compensation Funds' IBA Section on Business Law, (1996) 3 *Newsletter of Committee H (Insurance)* 13–19; Adrian Evans 'Professional Ethics North and South: Interest on Client Trust Funds and Lawyer Fraud — An Opportunity to Redeem Professionalism' (1996) 3 *International Journal of the Legal Profession* 281–300.

implicitly recognised not only the basis for government monitoring of fidelity compensation processes, but also the later demise of effective legal professional self-regulation in Queensland.

In early 1999 things became a lot more serious. No longer was fidelity compensation a 'back office' function of the society, with little impact on the future of the profession. The Brisbane *Courier Mail* began to take a far more active interest in the fortunes of the Law Society. In May of that year, the *Courier Mail* highlighted the fact that the fund had allegedly '... paid out \$8.4 million in claims between 1990 and 1998 but incurred \$17.2 million in operating costs, including salaries and rent paid to the Law Society.'¹⁸

Additional allegations aired by the *Courier Mail* included a supposed \$10.4 million in outstanding claims (a figure that, in fairness, was likely to be well above any final payments), a mere \$2.4 million in reserves and reports of a Law Society member objecting to the depletion of the fund by 'inappropriate' charges of rent, salaries and legal costs (including \$1.4 million on Statutory Committee meetings and — if correct — a massive 42% burden of total Law Society salaries).¹⁹ While not denying the figures, the Law Society responded with the reasonable assertion that the large gap between administrative expenses and claims paid did not take account of the lag in paying claims, such that a great deal of expensive investigation was necessary before a claim was admitted and that the eventual payments occurred, in some cases, years after the investigation was charged to the fund.²⁰ Unfortunately, there was no adequate or convincing explanation forthcoming from the Law Society as to the long-controversial practice of charging large sums for mainstream Law Society activities to the fund. In fact, the Law Society went on the front foot and, fatally forgetting that the interest earned on trust accounts was in no sense the property of the Law Society, actually challenged the Government to do a better job itself with the fund if it thought it could do so.²¹

This challenge, in hindsight, was foolish. Attorney-General Matt Foley quickly threatened to impose additional levies on practitioners to prop up the fund if the Law Society would not do so of its own accord and made it clear that there would be no Government bail out of the Law Society.²² Even more significantly, the Law Society's provocation may have encouraged the Government at least to consider taking over the fund, a course of action made politically attractive when the full extent of a major defalcation came progressively to light.

¹⁸ Paul Whittaker, 'Legal Fund's Costs Outstrip Payments to Fraud Victims', *The Courier Mail* (Brisbane), 1 May 1999.

¹⁹ *Ibid.*

²⁰ *Ibid.*

²¹ *Ibid.*

²² Sid Maher, 'Lawyers Face New Fee to Pay Victims', *The Courier Mail* (Brisbane), 6 May 1999.

IV THE 1990s SMITH MISSAPPROPRIATION AND ITS LEGISLATIVE CONSEQUENCES

Harry Smith, belatedly aka Flash Harry, was a Coolangatta-Tweed Heads practitioner with an unjustified reputation for trustworthiness. By order dated 14 April 1998, the Court of Appeal had removed Smith from the roll of solicitors in Queensland on the application of the Attorney General.²³ Smith, 53, was accused of stealing \$6.2 million from a group of about 30 former clients, mainly retirees who had known Smith through their local Catholic parish, and who had invested these funds in first mortgages through Smith's legal practice.²⁴ The case was extensively reported and the emphasis of these reports was almost always on the vulnerability of those who had been deceived by Smith: elderly 'sunshine' retirees, many not in good health,²⁵ who had come to know, or know of, Smith through the Church.

The fact that Smith had stolen significantly more than the meagre reserves of the fund could manage, was not lost on the profession,²⁶ even though the investigation 'lag' would inevitably reduce the shortfall over time. The Government knew also that it was time to become more directly involved in what could become, if unchecked, a damaging crisis of 'retiree' confidence in the Queensland investment climate.

V SOLICITORS' CONTRIBUTIONS TO FIDELITY FUNDING AND THE 1999 LEGISLATIVE AMENDMENTS

The profession was also aware that it needed to pay more to cover clients' losses. In May 1998, the Law Society had raised the general levy imposed on law firm principals to \$650 per practitioner per annum, to try to deal with the fidelity funding shortfall.²⁷ The government also tried (though not with spotless intent), to assist the Law Society in its efforts to levy its members. In his 27 August 1999 second reading speech of the Queensland Law Society Amendment Bill 1999, Attorney-General Foley was careful in his language but firm in the Government's determination to control the cost of current defalcation claims while amending the Act so that the Law Society might impose specific fidelity compensation levies, to ensure both that the fund was solvent in any particular period and that the Law Society would pay outstanding claims in full.²⁸

²³ *Court of Appeal of Queensland*, Appeal No 11284 of 1997, Order, 14 April 1998.

²⁴ Phil Bartsch, 'Solicitor Forced to Run the Gauntlet', *The Courier Mail* (Brisbane), 27 May 1999.

²⁵ Geoff Williams, Letter to the Editor, 'A Time of Reckoning' (August 1999) *Proctor* 3.

²⁶ Whittaker, above n 18.

²⁷ Maher, above n 22. As the Queensland Parliament Hansard makes clear, there was no ability to impose specific fidelity compensation levies beyond '...\$20 per annum and \$100 in a practitioner's career.' Queensland, *Parliamentary Debates*, Legislative Assembly, 27 August 1999, 3694 (Matt Foley, Attorney-General).

²⁸ Queensland, *Parliamentary Debates*, Legislative Assembly, 27 August 1999, 3694–3696 (Matt Foley, Attorney-General).

However, the Attorney's definition of 'in full' compensation was contested by the 'Smith Action Association'²⁹ and Lawrence Springborg, then Deputy Leader of the Opposition.³⁰ Both complained that the 1999 amendments were limited to allow recovery only of principal loans, *less* the interest that Smith had periodically paid. In effect, the Government's idea was to treat all the interest paid by Smith on principal, as *reducing* the principal, for the purposes of the eventual calculation in each case as to how much money was still owed. The Attorney's approach was morally wrong and, it must be said, far too reminiscent of Smith's own devious behaviour (and that of other solicitors in the past) in keeping unwitting clients in the dark about thefts of those principal sums by studiously maintaining payment of quarterly interest cheques to many of his clients.³¹ Mr Springborg described the provision as 'absolutely and completely immoral'³² and the *Courier Mail* reported that this manoeuvre would allow the fund to pay out some millions less than the full amount of the original loans and accumulated interest.³³ Adverse comparisons were made with the rights of New South Wales retirees who had also been defrauded by Smith, but who were said to be entitled to compensation *without reduction* for interest paid, under the New South Wales fidelity compensation arrangements.

Meanwhile, the Law Society continued to lament the diversion of the interest on trust accounts to legal aid and complain that, but for this government priority and (again), the requirement that 'honest solicitors ... continue paying for the mistakes of rogue solicitors', the fund would be solvent.³⁴

Mr Foley 'stonewalled' on paying all interest on the Smith losses for reasons that are not convincing.³⁵ The denial of full refunds to the Queensland victims of Smith was very unpopular with the electorate and a marked reversal of the normal practice across Australia in such matters. To divert public attention, the Attorney reported his 'pleasure' that the Law Society had decided of its own volition to impose whatever levies were necessary to finance the compensation, though the Bill reserved the right to the Minister 'to direct the Council in respect of claims and for levies to be able to be imposed by regulation.'³⁶

²⁹ Paul Whittaker, "'Raw Deal" in Fraud Fund Law Changes', *The Courier Mail* (Brisbane), 22 October 1999, 4.

³⁰ Queensland, *Parliamentary Debates*, Legislative Assembly, 8 December 1999, 6116–6140 (Lawrence Springborg, Deputy Leader of the Opposition).

³¹ It was not uncommon for solicitors stealing clients funds through participating or contributory mortgages, to distract their clients' attention by paying interest just often enough to give them a false sense of security. In the mid-1970s, Victoria solicitor Betty Bryant, principal of RW Barrie and Co, used this technique successfully for some time before her \$7 million thefts were discovered. See Robert Cornall, 'Considerable Sums of Money: A Short History of the Solicitors Guarantee Fund' (1995) 69 *Law Institute Journal* 12–14.

³² Queensland, *Parliamentary Debates*, Legislative Assembly, 8 December 1999, 6118 (Lawrence Springborg, Leader of the Opposition).

³³ Whittaker, above n 29.

³⁴ Sue Monk, 'Lawyers Fraud Fund Triggers Audit Warning', *The Courier Mail* (Brisbane), 11 November 1999, 1.

³⁵ The most that Mr Foley would offer by way of justification for the difference in treatment of Queensland claimants, was the fact that the amount of claims on the Queensland fund 'are much greater than those in New South Wales when it comes to this matter'. See Whittaker, above n 29.

³⁶ Queensland, *Parliamentary Debates*, Legislative Assembly, 27 August 1999, 3695 (Matt Foley, Attorney-General).

Yet the Attorney was not unsympathetic to the Law Society in all respects. Mr Foley acknowledged that the fund was ‘finite’ and that:

solicitors’ capacity to pay levies along with the other costs of regulation and practice [is] limited. The Government considers that it is unreasonable for the fund to be exposed to losses in respect of moneys placed with solicitors for investment purposes.³⁷

In deciding to exclude solicitors’ investment activities from fidelity compensation, the Government was, on one construction, engaged in social engineering by trying to return lawyers to their professional roots. The more pragmatic view, of course, is that the government did not want any future solicitor going down the Smith road.³⁸ Enough was enough: the idea that lawyers ought not to be so keenly engaged in business activity, that is, arranging mortgages on any basis, appealed to observers of the profession because of the perception that legal professionalism and commercialism do not mix.³⁹ Thus the further limitation of the grounds for fidelity compensation was notable because, while it helped the Law Society as a society, it also made the practice of law slightly less attractive to those of an entrepreneurial disposition. But the Government was in ‘return to basics’ mode:

The provision confines claims to traditional legal services as would have been contemplated when the fund was established. This provision is consistent with the amendments in 1996 excluding persons from claiming reimbursement from the fund for moneys invested in solicitors mortgage investment schemes.⁴⁰

By the time debate resumed on the second reading of the amending Bill, on 8 December 1999, plaintive pressure from the Law Society was continuous. In the December issue of the Law Society’s journal, *Proctor*, the Law Society returned to its polemical themes:

should solicitors be expected to pay for the crimes of other legal practitioners?, should solicitors take out voluntary private fidelity insurance?, should solicitors be obliged to disclose to clients whether they hold fidelity insurance?, if the legal profession’s competitors do not have to take out fidelity insurance, then Competition Policy says solicitors should not have to, should solicitors

³⁷ Queensland, *Parliamentary Debates*, Legislative Assembly, 27 August 1999, 3696 (Matt Foley, Attorney-General).

³⁸ Mr Foley was reported in October 1999 as changing the legislation to make ‘generous provision’ for Smith’s victims, by virtue of the \$650 levy on practitioners, though this levy was in the pipeline well before the full extent of Smith’s deprivations was recognised. See Whittaker, above n 29.

³⁹ See, eg, the ‘Statement on Professionalism v Commercialism’, *International Bar Association*, Amsterdam, September 1998.

⁴⁰ Queensland, *Parliamentary Debates*, Legislative Assembly, 27 August 1999, 3696 (Matt Foley, Attorney-General).

contribute annually to the Fidelity Fund and should there be exceptions for solicitors in government, corporations and advocacy? [sic]⁴¹

Noticeably, this Law Society list of concerns did not include the larger matters with which both government and profession were uncomfortable and which would then and now represent the ‘taboo’ agenda in fidelity compensation, for example:

- Why was [and is] the interest on trust accounts still diverted from clients in any event — given the capability of low-cost digital calculation of the amount of interest earned on clients’ daily trust balances, the existence of desk-based software to manage the process⁴² and the United Kingdom practice of paying at least some interest to clients?⁴³
- Considering — as a matter of substantive law — the uncompromising *fiduciary* obligation⁴⁴ of all solicitors to safeguard their clients’ financial interests, why was the policy process of the Law Society conspicuously inactive on these questions?
- Considering the same fiduciary duty — why had there been no Government or Law Society-auspiced, actuarial investigation of the cost-benefit relationship between allowing clients to retain their interest and the cost of that retention?
- Why was there no call from the profession to introduce an ethical rule requiring solicitors to consider and discuss with each client whether they could earn and be paid interest on their general trust funds (in the same way as formally ‘controlled’ monies earned such interest)?
- Who gained from all this, arguably (un)ethical, inactivity?

Whenever these issues are raised, it is said sincerely that the expropriation of interest is quite legal, that it is no different in principle to *taxation* and that the funds are used for legal aid purposes, against which no one argues. In response, the issue of legality misses the point. It is not the transfer *per se* that is questionable, but the practitioner’s decision to permit the transfer in the first place. The legislation which supports all diversion of interest in all States and Territories is merely permissive. Practitioners can and sometimes do choose to deposit large client balances in separate interest bearing accounts, usually when

⁴¹ Ian Muil, ‘Putting the Fidelity Fund in Perspective’ (December 1999) *Proctor*, 26.

⁴² Westpac for one, has a ‘Deskbank’ program that can pay interest to client accounts for individual practitioners, allowing them to offer lower net fees to clients by crediting their own interest entitlement against the cost of legal services.

⁴³ Evans, above n 1, 241–249.

⁴⁴ The issue came before the US Supreme Court in *Phillips v Washington Legal Foundation*, 524 US 156 (1998) in the context of a challenge to the use of Interest on Lawyers Trust Accounts (IOLTA) funds. The Court affirmed the (unremarkable) general principle that the owner of a capital sum is also the owner of the interest on that sum, unless that sum cannot be identified. Note also the earlier *Brown v Inland Revenue Commissioners* [1965] AC 244, where the House of Lords established the primacy of clients’ ownership of trust account interest under the fiduciary principles of Scots law. The case led to rules first gazetted in 1965 that provided — pre low-cost computing — for the payment of minimum amounts of interest to clients according to a table specifying a threshold capital amount held by practitioners in trust: see the *Solicitors Accounts Rules 1991* (UK) r 21(1).

they imagine it is likely that a client would *know* to expect the interest. But there is no compulsion to make such deposits.

Secondly, taxation is theoretically compulsory. The payment of *clients'* interest to all these purposes, noble as they are, is however, essentially optional: the diversion occurs because solicitors are not asked to turn their minds to their fiduciary duty to consider whether, in the light of modern technology, the capital they hold for clients could earn interest for them.

Thirdly, there is no contest with the assertion that much of the interest is used for socially important purposes, as mentioned above. That may be well and good if the utilitarian approach — the greatest good for the greatest number — is applied: but the alternative approach, that 'means are as important as ends' and that fiduciary obligations are not just imaginary, is crucial especially to law and lawyers.

It is doubly ironic that the public consensus in Queensland in 1999 was that interest was owed on trust funds that had been stolen by Smith, but *not* on principal that remained in trust with other law-abiding solicitors. Yet such interest entitlements — historically described by the profession as too inchoate to be accessible to individual clients⁴⁵ — were far from the immediate concerns of Harry Smith's victims, who remained incensed at the strengthening prospect of the fund treating the interest paid on their 'stolen' funds as reductions on principal. In the resumed second reading debate, Denver Beanland (former Attorney-General and Liberal member of the Opposition) correctly described the Labor Party's insistence on reducing repayments by the amount of interest paid by Smith, as 'anti-consumer',⁴⁶ but to no avail. The Bill was passed without substantial amendment and its principal provisions — statutory authority for the Law Society to levy dedicated fidelity fund levies (or for government to impose a levy by regulation in default of Law Society action), restrictions on the payouts to the Smith victims and limitation on future fund claims to strictly traditional activities of the legal profession, became law.⁴⁷

In the years before the major reforms of 2003–2004, the Government and the Law Society continued to spat about legal aid access to the interest on trust accounts⁴⁸ and the Government's insistence (with the support of the Opposition), that fidelity compensation was a non-negotiable obligation of the profession, in return for the privileges it enjoyed.⁴⁹ Relations between the Government and the Law Society never really improved and throughout this period, the Law Society was seemingly unaware that events were relentlessly

⁴⁵ See generally Evans, above n 1.

⁴⁶ Queensland, *Parliamentary Debates*, Legislative Assembly, 8 December 1999, 6126 (Denver Beanland). This view was supported by Mrs Cunningham (Gladstone, Independent), see 6129.

⁴⁷ *Queensland Law Society Amendment Act 1999* (Qld) ss 3–8.

⁴⁸ Chris Griffith, 'Lawyers Forced to Prop Up Legal Fund', *The Courier Mail* (Brisbane), 22 March 2000, 5.

⁴⁹ Queensland, *Parliamentary Debates*, Legislative Assembly, 8 December 1999, 6132 (Matt Foley, Attorney-General).

closing in and that the Government was increasingly determined to intervene not only in the fidelity fund but in just about everything else associated with legal practice in Queensland. The *Courier Mail* continued with its periodic coffin-nailing, lambasting the Law Society for failing to inform New South Wales authorities of Harry Smith's record when he was effectively forced to shut up shop in Coolangatta and move across the border to Tweed Heads.⁵⁰

A brief comparison with Victoria's fidelity compensation process is useful. When, in the early 1990s, the Law Institute of Victoria (LIV) was unfortunate enough to preside over a series of multi-million dollar thefts and, in consequence, over the technical insolvency of that State's Solicitors' Guarantee Fund, the then conservative government set to work with some determination to systematically reduce the influence of the organised profession in many aspects of Victoria's regulatory system. Solicitors' thefts of clients' funds are, of course, never the fault of law societies, but governments of both major parties will always seek to punish law societies which mismanage the financial consequences of those thefts. Since the only alternative scapegoat, after a multi-million dollar theft, is the Government itself — and no one in government is about to let that occur — the price to pay for a bankrupt compensation process is potential emasculation of the Law Society itself.

While in Victoria, the reduction in LIV influence that occurred in 1997⁵¹ now shows signs of a successful major power clawback by the profession,⁵² LIV recovery will not include regained control of fidelity compensation. It is probably too strong to say that the Queensland Law Society's handling of its fidelity compensation fund was solely responsible for the more far-reaching Queensland changes to regulation — in Victoria, the LIV did not have a *Baker & Johnson*⁵³ to contend with — there can be little doubt that Harry Smith, having put his former clients 'through hell and back',⁵⁴ has done his bit for diminished Law Society status in Queensland.

VI 2004 REFORMS TO FIDELITY COMPENSATION

After continuing but unsuccessful efforts by the Law Society to retain full control of the fund and the complaints process, the *Legal Profession Act 2004* (Qld) ('the Act') settles the current structure of both. In respect of defalcations, the Law Society retains only conditional management of the compensation process. 'Part 7 — Fidelity Cover' continues the Legal Practitioners Fidelity

⁵⁰ Sue Monk, 'Queensland Victims Short-Changed', *The Courier Mail* (Brisbane), 26 April 2001, 17.

⁵¹ The *Legal Practice Act 1996* (Vic) removed control of the fidelity compensation process to a Legal Practice Board and restricted the role of the Law Institute in complaint handling.

⁵² See Fergus Shiel, 'New System for Legal Complaints', *The Age* (Melbourne), 25 July 2003, 5. For a description of the clawback see Catherine Bragg & Ors, 'Hulls' Legal Reforms Will Help Only "Bad" Lawyers', *The Age* (Melbourne), 29 August 2003, 13 and immediate response by the Attorney-General: Rob Hulls, 'In Law Reform, Consumers Come First', *The Age* (Melbourne), 30 August 2003, 11.

⁵³ Jack Nimmo, Legal Ombudsman Queensland, Report on 'The Queensland Law Society and Baker and Johnson Lawyers', tabled by the Attorney-General in Parliament, 4 December 2002.

⁵⁴ Phil Bartsch, 'Solicitor Jailed for 10 Years or Scam', *The Courier Mail* (Brisbane), 21 April 2001, 4.

Guarantee Fund and vests it, as a fund, in the Law Society.⁵⁵ However, the Law Society is prohibited from borrowing money for the purposes of fidelity compensation,⁵⁶ except to the extent that, as a society, it lends its own money to the fund.⁵⁷

Significantly, the Attorney-General may now require the Law Society to report to him or her at any time concerning the fund and that report must be delivered within 14 days,⁵⁸ while any anticipated delay beyond one year in making payments to a claimant must be justified in writing to the claimant.⁵⁹ The Law Society may not cap payments under the fund except to the extent of the actual pecuniary loss of the claimant⁶⁰ and both costs and interest (the latter generally at 5% per annum, unless a regulation provides otherwise)⁶¹ are payable to their full legitimate extent.⁶² Additionally, the Government may by regulation itself cap payments under the fund.⁶³

Finally, the Act establishes a Legal Practitioner Interest on Trusts Account Fund to receive all interest on trust accounts and to hold same entirely within Government accounts.⁶⁴ Further, the Minister now has complete control of all payments from the fund, including payments to the fund for fidelity compensation.⁶⁵ Interestingly, the Minister can, if he or she wishes, choose to reimburse retrospectively the Law Society for liabilities already incurred to previous fidelity compensation claimants,⁶⁶ but there is no compulsion whatsoever upon the Government to do so. In fact, government need not make any payments for any of the former applications of trust account interest, such as legal aid or the administrative or regulatory expenses of the Law Society, though in practice it is likely that legal aid will receive regular and more or less predictable funding. In relation to the other ‘beneficiaries’ — regulators, the Supreme Court Library, law reform, legal education — it is clear from the structure of this part of the Act⁶⁷ that the decision about how to allocate all this money will be made on an annual basis by government alone.

The humiliation of the Law Society implicit in the requirement to seek annual funding from the Executive — and the paradoxical possibility that the Law Society will thereby be less independent of future Governments — is now

⁵⁵ *Legal Profession Act 2004* (Qld) s 147.

⁵⁶ *Legal Profession Act 2004* (Qld) s 149(1).

⁵⁷ *Legal Profession Act 2004* (Qld) s 149(2).

⁵⁸ *Legal Profession Act 2004* (Qld) s 155.

⁵⁹ *Legal Profession Act 2004* (Qld) s 176.

⁶⁰ *Legal Profession Act 2004* (Qld) s 169.

⁶¹ *Legal Profession Act 2004* (Qld) s 171(3).

⁶² *Legal Profession Act 2004* (Qld) ss 169–171.

⁶³ *Legal Profession Act 2004* (Qld) s 182. This has been done. The maximum amount that can be paid for an individual claim is \$200,000, and the maximum that may be paid in relation to a given law practice is \$2 million: *Legal Profession Regulation 2004* (Qld) s 21.

⁶⁴ *Legal Profession Act 2004* (Qld) s 208(2).

⁶⁵ *Legal Profession Act 2004* (Qld) s 209(1)(b).

⁶⁶ *Legal Profession Act 2004* (Qld) s 209(2).

⁶⁷ *Legal Profession Act 2004* (Qld) ss 209–211.

complete in Queensland and stands as a warning to other law societies still hanging on to trust account interest: do not allow fidelity compensation to unravel. In May 2004, Attorney-General Rod Welford, made this response to a Dorothy-Dixer from a Labor member about the source of the funding of the Law Society wine cellar and a key ingredient in the determination to reform the whole of legal professional governance:

There is no question that the Queensland Law Society should not be using money allocated for regulatory activities to conduct membership functions. This is the very reason our government is removing control over interest on solicitors' trust accounts from the Law Society. This is at the heart of our legal profession reforms.⁶⁸

VI CONCLUSION

Mark Lunney, who has written the most comprehensive early history of the fidelity compensation process in Queensland, observed in 1996 as follows:

The impression given by the [1930s] records is that the Law Society reacted to events, and that the introduction of the fund was an attempt to convince the public firstly that solicitors could be trusted and secondly, and more importantly, that the Statutory Committee could be trusted with the discipline of the profession. No doubt many practitioners did believe the fund was a good thing, but the timing of the introduction of the fund at least partly suggests that it was introduced as an expedient device to deflect criticism rather than a bona fide measure to improve the lot of clients. The fidelity guarantee scheme was a quid pro quo for retaining the law society control of the profession, control it retains today.⁶⁹

As in Victoria shortly beforehand, Law Society control of the fund has, in just a few years, been forfeited, consequent on the failure of the scheme to stay in the black. Yet fidelity compensation itself is firmly on the agenda throughout the western world and there is no serious suggestion that it should be wound back. On the contrary, the International Bar Association has in 2004 commenced an online survey designed to gauge both the level of current compensation arrangements in member bars and societies, and define what still needs to be done to improve compensation processes in all jurisdictions.⁷⁰ Included in that survey is a series of questions designed to clarify the financial fundamentals of all such schemes — who benefits from them? Thus each member bar association is asked to detail what arrangements are in place to require practitioners to

⁶⁸ Queensland, *Parliamentary Debates*, Legislative Assembly, 18 May 2004, 1086–7 (Rod Welford, Attorney-General).

⁶⁹ Lunney, above n 2, 48.

⁷⁰ The survey has been conducted by Committee 23 of the International Bar Association, under the chairmanship of John Moorhouse, of the Attorney's Fidelity Fund, South Africa. Interestingly, South Africa is one of the very few jurisdictions that still utilises clients' interest to pay for fidelity compensation. See *IBA Client Protection Fund Survey — 2004* (2004) International Bar Association <<http://www.ibanet.org/cpsurvey>>.

inform *all* their clients of their potential to be paid interest on general trust balances.⁷¹

Client fidelity compensation — a moral necessity of legal practice — is not enhanced by clients' ignorant acquiescence in the diversion of interest on their funds, in order to finance that compensation and much else. Queensland lawyers, along with the rest of the Australian profession, face no government pressure on this point because almost all involved are victims of conflicting interests. The new Queensland structure, otherwise so determined to free itself of the past, still underlines this conflict.

Since the interest on trust accounts was first identified and diverted to its many destinations, no effort has been made by any stakeholder to consider solicitors' fiduciary and moral responsibilities to their clients in respect of that interest. It is as if the advent of digital computing has not occurred and the issue remains an ethical sink hole of which even discussion is discouraged. No court in this country has had a realistic opportunity to comment on the avoidance of the fiduciary responsibility and it is hard to identify any potential litigant with standing who would be willing to incur the costs of such a challenge. Regrettably, change will probably occur only when solicitors' trust accounts are themselves made redundant, not by better ethical consciousness, but by increasing reliance on direct payment technologies.

⁷¹ *IBA Client Protection Fund Survey — 2004* (2004) International Bar Association
<<http://www.ibanet.org/cpsurvey>>.