A Concise History of the Solicitors' Guarantee Fund (Vic): A Marriage of Principle and Pragmatism

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Action in the public interest is at the apex of legal professional aspiration and represents the moral basis for the assertion by lawyers of their professional autonomy. Compensating clients for thefts by their lawyers is a crucial aspect of legal professional accountability. The history of defalcation compensation in Victoria is an 80 year story about clients and their lawyers, politicians and consumers, ethics and pragmatism. It is a history of an essential Victorian Law Institute initiative in the public interest. It is also a vehicle for the study of some vexed conflicts between public and private purposes in the funding of the entire legal regulatory structure in Victoria. In commenting on these conflicts, this article suggests a new ethic to govern the on-going tension between private and public interests.

PREFACE

This history is derived from a wide range of sources, including some that are not within the public domain. Application under the *Freedom of Information Act* (Vic.) 1982 has been made to the Department of Justice for access to the Attorney-General's records of the SGF and some documents have been copied, though many have been denied. Nevertheless, the Department, together with the former Legal Aid Commission of Victoria, has allowed me to peruse their files extensively, upon condition that no copies of any documents were made. I have had discussions with officers of the former Law Institute of Victoria (LIV), former and practising solicitors and various SGF beneficiaries. Apart from early LIV archives held by the University of Melbourne, I have not been able to peruse relevant LIV files. SGF files relating to the period from the commencement of the Fund (1948) until the present (and not destroyed by fire in 1978) are not subject to Freedom of Information. I have requested informal access but this has not been successful. Some key personnel at key periods in SGF history have felt it inappropriate to discuss SGF matters.

In respect of the section entitled 'Competing Interests', I have not in consequence been able, in some cases, to verify assertions of certain informants who have not been willing to be cited as the authors. Where such verification has not been available, I have alluded to the general context of the assertion and inferred the point I wish to make. I have also forwarded copies of that section to various correspondents in an effort to check facts and assertions and have amended them where responses have permitted. In some cases, respondents have taken issue with the relevant assertions. The final form of this history, which concludes at 30 June 1996, records such differences of recollection, interpretation or opinion.

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INTRODUCTION

The Solicitors Guarantee Fund (hereafter referred to as SGF) was established by the Law Institute of Victoria in 1948 with the sole and principled aim of providing a means to compensate clients of solicitors whose funds were misappropriated. It has provided an essential public service and expanded into a complex structure with wider aims than fidelity compensation and considerable implications both for professional ethics and the financing of the socio-legal establishment in Victoria. Despite the recent reforms to the structure of the legal profession in Victoria under the *Legal Practice Act* 1996 (Vic) (hereafter referred to as *LP Act* 1996 (Vic)), these issues are of continuing importance.

The SGF received a small levy from each practising solicitor ($10 per annum), moderate amounts of interest on investments and millions of dollars in interest earned on the deposits of clients' funds in solicitors' trust accounts. Recently, the levy has increased markedly, but these funds — which might have been the earnings of clients if the monies in question had not been lodged with the solicitor and dealt with in the manner required by the *Legal Profession Practice Act* — have come to support the compensation process and much else.

BEGINNING IN THE UNITED KINGDOM

Victorian recognition that action in the public interest was necessary in order to compensate clients for solicitor defalcations first occurred in the late 1920's, as a result of problems throughout Victoria. In the early days of the Port Philip settlement and then of the Victorian colony, the solicitors of Melbourne, Ballarat and Bendigo were very successful. They had developed large mortgage practices in consequence of the gold discoveries in the latter half of the century and rivalled the banks as a source of funds. However, solicitors' large personal bank balances aroused temptation, especially when there was no separation of a solicitor's own funds from those of clients.

It is no surprise that early solicitors had their share of muddlers and opportunists in their midst. In the last decade of the 19th century, practice 'failures' — which were often confused episodes with little clarity as to whose money had gone or where it might be located — became common. In periods of general economic stress, their frequency increased to the point of notoriety. Even so, professional recognition of the need for action did not occur first in Victoria.

At the turn of the century the Boer War turmoil (1899–1902) caused a sharp fall in the English stock market, taking a number of respected legal firms into bankruptcy. Since English solicitors (like their colonial brethren) also commonly co-mingled their own funds with those of their clients,[1] the effect upon

[1] Kenneth Jarvis, 'Negligence and Fraud — Symptoms of Malaise 2', Meredith Memorial Lecture, Faculty of Law, McGill University, 1984, cited in American Bar Association, Centre for Professional Responsibility, *Model Rules For Client Protection* (1995) 1.

public confidence was especially significant. The Law Society for England and Wales became concerned by the large proportion of these firms who had taken quantities of their clients' monies down with them.[2] A special general meeting of the Law Society Council on 27 April 1900 decided to appoint a committee to investigate. Its report recommended the creation of a criminal offence where clients' monies had been misappropriated, speedily adopted in the *Larceny Act* 1901 (UK), and the separation of solicitors' and clients' funds.[3] The second idea, apparently so basic today, was nevertheless resisted, at least partly on the basis of the bookkeeping consequences. Frauds continued and, as numerous cases in almost every jurisdiction since have demonstrated, the perception that change was needed appears to have followed from a series of major thefts rather than proceeded from any particular ethical philosophy.[4] In December 1906 a Solicitors Practice Committee convened and quickly recommended separate, proper accounts to be regularly balanced, the application of funds only as directed, payment of interest on those accounts to clients, retention of clients' funds for the shortest possible time and separate deposit accounts for funds to be held for a lengthy period.[5]

Although each recommendation was accepted by a Law Society general meeting held in July 1907, intentions evaporated as the head of public steam dissipated. It took another 26 years for statutory rules to be made in relation to handling clients' funds.[6] It was 57 years before legislation recognised that interest did in fact belong to clients.[7]

Discussion in the UK about the need to make good losses from these thefts proceeded almost contemporaneously with the collective anxiety surrounding prevention. Bonds, to be forfeited in the event of default, were canvassed but rejected because of the cost to young (and therefore undercapitalised) solicitors,[8] and the indemnity (fidelity or compensation) fund idea also languished in the face of very plausible arguments. These had been put forcefully in 1900 in a report to the Liverpool Law Society:

> It was a factor in all these schemes that the insurance or guarantee fund should be provided at the cost either of all practising solicitors ... the honest practitioners were to find the money for indemnifying the victims of their dishonest brethren. All the schemes proposed seemed to me unfair to the former class and to be positively harmful because they would induce the client to repose unlimited confidence in a man unworthy of it for even if loss

2 Harry Kirk, *Portrait of A Profession* (1976) 100.

3 Ibid.

4 (1906) 51 *Solicitors Journal* 151, remarked 'owing to recurring frauds by solicitors distrust has been growing among the public', cited in Kirk, above n 2, 101.

5 Ibid 102.

6 *The Solicitors' Act 1933* (UK) resulted from another spate of thefts, finally compelling separate solicitor and client sets of accounts, ibid 103.

7 The decision in Brown v Inland Revenue Commissioner s [1965] AC 244, forced the introduction of rules prescribing the manner in which interest was to be accounted to clients. See AH Evans, *The Development and Control of the Solicitors Guarantee Fund (Victoria) and Its Ethical Implications for the Legal Profession* (LLM Thesis, Monash University, 1997) Ch 3 pp 156–160 and Ch 6 pp 237–240.

8 Kirk, above n 2, 104.

> to the client would result he would know that he could obtain indemnity from the profession at large. The tendency therefore would be towards a relaxation of those precautions on the part of the client to which no honest solicitor ought to object.[9]

The 'unfairness' theme pervaded early discussion in most jurisdictions (and much discussion since, especially when funds verge on insolvency, as in Victoria and New Zealand[10]), but there was also the additional problem that membership of law societies was not compulsory and, at that stage, the political culture reposed all legal professional issues in the organised profession. There was no thought that a compensation fund could proceed under the auspices of anyone if not the collective profession, and that meant all practitioners in or none. It seems there were insufficient thefts after 1906–7[11] to stir the pot sufficiently, and the momentum shifted south to New Zealand in the late 1920's, where peace did not prevail.

THE NEW ZEALAND INITIATIVE

The level of theft in New Zealand in 1926–27 was such that the NZ Law Society persuaded the Government to introduce a Bill in 1928 entitled 'The Law Practitioners Amendment (Solicitors' Fidelity Guarantee Fund) Bill'. The Bill followed upon a resolution by the Association of New Zealand Chambers of Commerce, presented in February 1927 to the Law Society, advising

> [t]hat this Conference brings before the Law Society the necessity of Solicitors handling trust monies, subscribing to an adequate indemnity insurance, or failing that, the Law Society provides a guarantee fund to admitted solicitors similar to the guarantee funds provided by the banks.[12]

Unfortunately, due to a dissolution of Parliament, the Bill did not advance beyond a second reading in the Lower House. A second Bill, also to establish a Solicitors' Fidelity Guarantee Fund, was however passed in 1929 to become the *Law Practitioners Amendment (Solicitors' Fidelity Guarantee Fund) Act* 1929 (NZ). Despite the earlier English activity, this legislation was the first to attract serious attention in Victoria, and the theme then, as now, was the desire to assist public confidence in the legal profession. The New Zealand Law Society editorialised in its Journal as follows:

> The fact that the Fund is provided at its own expense, by the Profession as a whole, not only to assuage cases of hardship, but to meet, as far as

[9] Speaker unknown, Liverpool Law Society, Annual General Meeting, 28 November 1900; cited in Kirk, above n 2, 104.

[10] Evans, above n 7, Ch 3 pp 174–5.

[11] A 1908 provision required deposit of clients funds into trust accounts. Law Practitioners Act 1908 (UK) s 47, cited in 'Model Rules For Client Protection', above n 1, 2, and provision for trust audit rules was made in 1913. *Law Practitioners Act* 1913 (UK) s 14, cited in 'Model Rules For Client Protection', above n 1.

[12] Minutes of the Council of the New Zealand Law Society, 25 March 1927, cited in 'Model Rules For Client Protection', above n 1.

> possible, the reproach levelled at the whole Profession when one of its members defaults, should go far to restore public confidence in the integrity of a Profession which has to some extent been shaken by the wide publicity given in recent years to a few cases of breach of trust by solicitors.[13]

The NZ Journal was also ready, as best it could be, for anticipated criticism that the establishment of the Fund merely emphasised declining professional standards:

> Compared with the Profession elsewhere, either in England or in the other Dominions, such statistics as are available relating to breaches of trust by solicitors show New Zealand solicitors to have maintained the trust placed in them not less well or carefully than those in any other country, and to the critics who infer that the establishment of such a Fund argues ill for the standard of integrity maintained by one section of the community as compared to others, the answer is that the *necessity of the Profession* (emphasis added) demands not merely a high standard, but the highest standard, and that it is to secure the maintenance of the highest standard in the Profession as a whole, and to mitigate the hardship that arises from any deflection from that standard, that the Profession has promoted the Bill. The establishment of the Fund not only binds closer its members, but also protects the public.[14]

It should not be surprising that in 1929 solicitors were acting from mixed motives. Fortuitously, a mixture of self interest and public interest intersected and allowed what were opposing views in the profession to be brought together. The result was an ethical, innovative and practical mechanism for client compensation. The NZ fund was to be vested *in trust* in the NZ Law Society. Its income consisted of annual contributions per practitioner of between £5 and £10 and additional levies (if necessary) of up to £10 per practitioner annually. Practitioners could not be required to pay more than £50 in additional levies during their entire period of practice and no contributions at all were payable after the Fund reached and retained a £100,000 balance. The basic fund was a primitive insurance scheme and the Council of the NZ Law Society had power to reinsure the capital sum, but it confidently expected that the £100,000 limit would be sufficient in all circumstances.[15]

Early experience confirmed this confidence and similar schemes were enacted in succeeding years in Australia. Queensland was the first in 1930, with Western and South Australia, and New South Wales following suit.[16] The

[13] New Zealand Law Journal, 17 September 1929 page unstated; cited in (1929) 3 *Law Institute Journal* 189.

[14] Ibid.

[15] above n 13.

[16] Robert Cornall, 'Considerable Sums of Money: A short history of the Solicitors Guarantee Fund' (1995), 69 *Law Institute Journal* 12–14. See for example *The Queensland Law Society Act* 1952 (Qld) s 9(2)(F). Queensland apparently introduced its scheme in an effort not only to compensate defrauded clients, but also to 'convince the public ... that the Statutory Committee could be trusted with the discipline of the profession'. See Mark Lunney, 'The Solicitor and the Bookmaker — the Foundation of the Solicitors' Compensation Fund' (1996) *Queensland Law Society Journal* 35–48

first Canadian fund began in Alberta in 1939[17] but it would seem that the idea did not travel south from Canada. It has been suggested that fidelity compensation began in the United States only as a result of the war time observations of a Californian in New Zealand, who returned home to write about the concept in the California State Bar Journal in 1946.[18] The first American fund (in Vermont, 1959) took some time to establish despite prior ABA discussion over a five year period.[19]

In England and Wales, the Atlantic stock market 'crash' and subsequent defalcations of 1930 resuscitated the debate. The Solicitors Journal reiterated a 'Times' report that some UK Government members would sponsor legislation if the profession itself did not set up a fund.[20] When the 'separate accounts' rules were introduced in 1933 (below p 18) the pressure for a fund became increasingly irresistible because of the need to demonstrate to the public a 'cure' as well as prevention.

The *Solicitors Act* 1941 (UK) established a Compensation Fund from 1 November 1942.[21] Significantly, the Law Society acquired the power to compel all solicitors to belong to both the Fund and the Society, just as subsequently occurred in Victoria in 1946 (below pp 16–18). In hindsight, it is ironic that the advent of a compensation mechanism (which was intended to reduce pressure on solicitors) was the vehicle for far more regulation and control as time went by. Nevertheless, the language used in support of the England & Wales Compensation Fund was an understandable mixture of self interest and apology:

> Nothing will so much help to restore some of the public confidence we have lost as the institution of a relief fund. Money talks. Nothing is so convincing as cash down. When the public sees that we are willing as a profession to put our hands in our pockets and do what we can to meet cases of hardship caused by the defalcation of members of our body — when they see that, they will know that at least we mean business . . . A relief fund on the lines suggested is neither dishonourable nor despicable but just the reverse, and this is the finest gesture that this profession could make.[22]

[17] *Legal Profession Act* 1939 (Alberta) s 31(a), cited in 'Model Rules For Client Protection Funds', above n 1.

[18] Kenneth J McGilvray was the reputed observer. See American Bar Association 'Report on Clients' Security Funds 5' (1964), cited in 'Model Rules For Client Protection', above n 1, 3.

[19] Ibid.

[20] 74 *Solicitors Journal* 313; cited in Kirk, above n 2, 105 at n 81, which alluded to the recent New Zealand legislation as a contributing factor to the recognition that a fund was needed.

[21] Kirk, above n 2, 105.

[22] Law Society Journal, 1st February 1943, cited in (1945) 19 *Law Institute Journal* 16.

VICTORIAN HESITANCY

In the light of developments elsewhere, it is perhaps surprising that Victoria, which also suffered from defalcations,[23] failed to follow suit with appropriate legislation until the late 1940s. It is possible that rural political considerations, including mistrust of the Melbourne based LIV, came into play.

In 1930, the President of the Law Institute, and the first to push for legislative change, was Bill Slater. A co-founder in 1935 of the firm Slater and Gordon, he became the Attorney-General who finally introduced the legislation in 1946.[24] By 1931 he had introduced a Bill — drawing in part on New Zealand's approach — requiring solicitors to insure themselves by way of fidelity bonds that were liable to forfeiture in the event of a claim;[25] but this Bill did not pass the Legislative Council.[26] Although Hansard does not reveal why it failed, LIV archives of the period 1930–31 record sufficient of the exchanges between members of the profession to explain the hesitancy.

A special LIV Council meeting on the 6 of March 1930 records Mr Chas. Hugh (C H) Lucas, later to become the LIV nemesis on the issue, as moving the creation of a compensation fund. He quoted to the meeting the comments from Hansard of a Mr Glowry MP, concerning the then spate of defalcations, as follows:

> Perhaps the worst case of all was that of a woman who went to Nash and lost a lot of money. She then chose for her solicitor Mr Williams and said "If anything like that ever occurs again in my experience, I will go the full length and get the man into goal", and Mr Williams said "Quite right, quite right, madam", in unctuous agreement. He lifted one thousand pounds from her and then committed suicide.[27]

In reply to Mr Lucas, another member (Mr Crowther) said:

> I can only look at the thing through the spectacles of my own personal experience. I have yet to be convinced that the public of Victoria has lost faith in the legal profession as represented by the Law Institute of Victoria. Unless the public of Victoria has lost faith in the profession, then we, by putting forward a scheme of compulsory insurance, compulsory contribution, or whatever else you like to call it, are only undermining the confidence in the profession itself. We are doing the very thing which to my mind we ought not to do until it has been proved up to the hilt that the necessity for such action exists. In my opinion that necessity does not exist.[28]

[23] 'during the last 20 years, 50 solicitors defaulted to the extent of £300,000 . . . (and) of (that) sum, more than £200,000 was the outcome of defalcations by seven solicitors.' Victoria, *Parliamentary Debates*, Legislative Assembly, 1946, 3848 (Mr Bailey, Member for Warrnambool)..

[24] 'Considerable Sums of Money', above n 16, 12.

[25] Fidelity bonds have now lost favour internationally in comparison to compensation funds supported by practitioner levies.

[26] As recited in Victoria, Parliamentary Debates, Legislative Assembly, 1946, 3557.

[27] See 'Confidential Report' of LIV discussions on a 'Bill to Establish a Solicitors Indemnity Fund', 2, held at the LIV on 6th of March 1930, archived in the University of Melbourne Archives, Box 8, ref: 8/1/8/1 to 8/1/51 and see 'Audit of Solicitors Trust Funds', *The Law Institute of Victoria 1859–1959*, Law Institute of Victoria, (1959), 50.

[28] Ibid 13.

The tenor of the discussion in that meeting was focussed on the scale of the problem. Mr Crowther considered the issue to have arisen only in the last 2–3 years,[29] (unlike, in his view, New Zealand with '30–40 years' of difficulties)[30] but he was contradicted by a Mr Cook from the Bendigo Law Association, who said that they had had a series of defalcations, 'one after the other', over the last 10–12 years.[31] Debate swung back and forth. Mr Chomley complained that 'Since the day of Dickens this profession has been sneered at . . .'[32] and although Mr Rigby stated bluntly that 'I am afraid of Parliament. I am afraid of the feeling in Parliament and if we do not voluntarily do something, Parliament will hit us much harder than we may expect.',[33] the view that the situation was not desperate, prevailed. Mr Lucas' motion for change was not seconded on that day.[34]

The redoubtable Mr Slater was however, undeterred. At a further Council meeting two months later, his view that the 'feeling of the house is very strong' was reported to members with some energy by Mr Burt,[35] who reminded members that 'In NSW the profession has, in fact, been threatened (with a private members' Bill).'[36]

Debate began as to the content of the proposal. A key issue was the contest between 'compensation' via a fund and/or 'prevention' with an annual audit. On this topic, Mr Lucas spoke with his usual pungency:

> Some say an [compulsory] audit is the right thing and not an indemnity fund. If they say that I cannot see that it answers the requirement of the people who have lost their money to be told that moneys were all right at the last audit . . .,[37]

but he remained frustrated by the inactivity. Further meetings on the 15 and 19 of May 1930 deferred all action.[38] Debate see-sawed for many months until the call for change was diffused when the LIV Council put the problem to its constituents. A general meeting of 177 practitioners on the 5 April 1932 then affirmed that:

> the principle of casting upon reputable and honorable members of the legal profession the liability to make good the defalcations of dishonest ones [is to be] strongly denounced.[39]

[29] Ibid 11.
[30] Ibid.
[31] Ibid 20.
[32] Ibid 30.
[33] Ibid 33.
[34] 'Audit of Solicitors Trust Funds', *The Law Institute of Victoria 1859–1959*, Law Institute of Victoria (1959) 50.
[35] Minutes of 'Special Meeting of LIV Council' re a 'Solicitors Guarantee Fund', 1 May 1930, 9; LIV Archives, University of Melbourne Archives, Box 8, ref: 8/1/8/1to 8/1/51.
[36] Ibid 5.
[37] Ibid 7.
[38] 'Audit of Solicitors Trust Funds', *The Law Institute of Victoria 1859–1959*, Law Institute of Victoria (1959) 51.
[39] See 'Re Solicitors and Trust Funds: Summary prepared for the use of Mr Piesse', dated 5 May 1933, 2; LIV Archives, University of Melbourne Archives, Box 8, ref: 8/1/8/1to 8/1/51.

The then Attorney-General for Victoria, RG Menzies, 'indicated that the Government would[40] be guided by the Profession' and the LIV swung away from the idea of a fund and back towards reliance on criminal sanctions.[41]

Throughout the 1930s the issue was kept alive by C H Lucas. He seemed to have a flair for needling the LIV Council[42] and, particularly, each new President. He wanted a fund *and* an audit and pursued this agenda each year, eventually with some success. In a 1936 letter to Wallace Ball, then LIV President, he launched forth:

> I would be delighted to hear of a better mode of keeping defalcations down and restoring stolen money than has been in force so long in New Zealand and Queensland ... Anything less beneficial to clients...is surely not worth consideration. NSW has proved this. They have no compulsory audit, and ... The fact that there *is* a fund brings in claims, only to disclose that NSW enacted merely a half-measure ...
>
> I have said I would be glad to cooperate and I mean it. However, mutual respect is essential to co-operation. For instance, to interrupt what I had to say at a general meeting and tell me my time was not unlimited and not to say how many more minutes were left certainly curtailed an unpopular speech, but was it worthwhile?...Similar was the rising to a so-called point of order that I should not speak of dishonest solicitors who had died. Since Victorians still live to complain of ruin the motive behind the point of order was not creditable ... Such evidence, Mr President of spleen substituted for logic is unworthy of a serious subject. Make-believe is useless, we all know how bad the state of things is among some solicitors now in practice.[43] [emphasis in the original]

In 1936 Slater's Bill to compel solicitors to maintain separate trust accounts did become law,[44] providing penalties for breaches and enabling the Attorney-General to order inspections of solicitors' books of account.[45] However, as Slater outlined some years later[46] defalcations continued and many of those occurring in the days before the eventual 1946 Act rarely became public knowledge in any general sense.[47] Mere awareness of the problems was, it seems likely, slow to transform itself into public agitation:

> in order to save clients as much as possible from the wreck, a compromise agreement has to be entered into with a solicitor who has gone wrong. Those cases are never made public; they never reach the arena of the Criminal Court, nor are they touched upon in the Bankruptcy Court. Solicitors often find that they cannot press a man who has gone wrong because, by

40 'Audit of Solicitors Trust Funds', *The Law Institute of Victoria 1859–1959*, Law Institute of Victoria (1959) 51.

41 Ibid.

42 In April 1933 he wrote to the Council stating that he would 'stir' the issue up again, Ibid.

43 Letter from CH Lucas to Wallace J Ball Esq, President LIV, 10tDec 1936; LIV Archives, University of Melbourne Archives, Box 9.

44 *Legal Profession Practice Act* 1936 (Vic) ss 3 and 4.

45 *Legal Profession Practice Act* 1936 (Vic) s 6.

46 above n 26.

47 One report,'£200,000 in Ten Years: Solicitors' Default', *The Argus*, 28 July 1939, 11, did assert that there had been 45 defalcations in 10 years, losing about £200,000.

> refraining, they may be able to save something for their clients . . . In many instances it is extremely difficult to get clients to take proceedings against defaulting solicitors[48]

In 1938 the Law Institute proposed a further Bill, although it was still only a modest change. Returning to the concept of fidelity bonds, the Bill would have given rule-making power to the Institute and included a requirement for annual statutory declarations as to compliance with the rules and prudent management of trust accounts. The Liberal Attorney-General of the day — the successful Western District solicitor and MLA for Warrnambool, Mr Bailey — would not co-operate however, despite more representations from Slater and from members of the Liberal Party.[49]

As he later explained,[50] Mr Bailey was aware that the Bill would '. . . give the Law Institute power practically to govern the legal profession . . .', even though the rule-making power was to be (and still is) subject to the approval of the Chief Justice. In particular, he considered it inequitable that country practitioners with small practices would be required to pay the same fidelity premiums — between £5 and £10 p a. — as big city firms. He was also concerned that the fund would be too small to offer real assistance, concluding that the '. . . legislation gave little protection to clients'.[51] Mr Bailey was, of course, a rural practitioner and it may be assumed that the flat rate contribution issue bore more heavily upon him than upon urban lawyers, but, if Hansard reflects his views accurately, he was not deaf to the calls for a workable mechanism. His ideal alternative was based on a 'seeding' grant of £10,000 from the Supreme Court Library Fund, (avoiding expensive 'up front' fidelity premiums) supplemented by practitioner contributions and an additional 'call' upon the library fund for £25,000, the last to be insured by Lloyds at an annual premium of £600. Lloyds were apparently prepared to reduce the premium to £200 per annum after contributions had reached £20,000, and the entire arrangement would require an initial per capita contribution of just 12s.6d. and annual contributions of only £2.2s.[52] It is not entirely clear why such a scheme remained dormant while Mr Bailey was the Attorney, but political uncertainty in Europe may have put the scheme lower on the list of priorities.

48 Ibid.

49 Ibid. Pressure was also building against reliance on statutory declarations. In a letter from the Australian Women's National League to the LIV, it was recognised that a compensation fund had to be supported by the audit of trust accounts. See letter from Mrs Claude Couchman, President ANWL to FR Gubbins, President LIV, 11 August 1939; LIV Archives, University of Melbourne Archives, Box 9.

50 above n 46, 3847–8.

51 Ibid 3848.

52 Ibid 3850.

INSURANCE APPROACH ABANDONED IN FAVOUR OF COMPENSATION

In 1940, the Institute to its great credit made its last unsuccessful proposal to the Government with a Bill based on a principle that (for the first time) combined 'maximum compensation for loss [whilst relieving] the profession of unduly heavy burdens'.[53]

The idea involved a move from insurance concepts of risk management (as it turned out, a fateful decision) towards loss compensation and the direct matching of claims with levies. The proposed 'Guarantee Fund' was to be financed by annual contributions of between £5 and £10 per practitioner and was to be supplemented, if necessary, by annual levies of up to £10 per practitioner with a £50 limit on such levies during the whole period of practice for each member. The similarities to the New Zealand fund of 1929 were strong. A £10,000 'cap' on contributions was to apply (per solicitor or firm) after the Fund had been operational for 7 years. Solicitors were to be required to obtain an annual practising certificate, the issue of which was conditional upon either the completion of a statutory declaration as to the management of trust funds or an audit report of the trust account. The best that can be said about the alternative nature of these conditions was their hopeless naiveté, but, to be fair, they were reflective of great mistrust about centralised control.

Perhaps for this reason, the LIV Council could not heed a warning about the necessity for audits, which it had received at the end of 1939. In a letter from the Chairman of the (then) Chartered Institute (of Accountants) to the Council, its Chairman wrote:

> I see by your report [above, note 47] that the loss is estimated at £200,000, in little more than 10 years past, and that the number of defaulters in that period has reached the rather shocking total of 45....in my own experience as Trustee of the bankrupt estates of some of these defaulters ... [the losses in five of these estates are] ... over £97,000. I should say the total loss for 45 defalcations is probably under-estimated at £200,000 ... [A]ny of these frauds would have been immediately disclosed by an audit inspection of the books. When I say immediately I do not exaggerate ...
>
> The fact of the matter is that these frauds are not committed with any deliberate and calculating intention of purloining any particular sum as is suggested in support of the argument that an audit cannot be effective. They were in every case of my experience the outcome of negligence in the first case and later withdrawal of funds in excess of profits of the business, with the inevitable result of trespass upon the funds of clients. In one of the above cases this steadily increasing misappropriation had been going on for not less than 20 years and every instance was a case of excessive withdrawals — at first muddled and possibly more or less unintentional and later with deliberate knowledge. In face of this experience, ... an audit would be completely effective against the kinds of fraud that actually do occur.[54]

[53] above n 46.

[54] Letter from Mr Outhwaite, of Young and Outhwaite, to President LIV, 15 December 1939; LIV Archives, University of Melbourne Archives, Box 9, ref: 8/1/38.

As World War II advanced, the Council of the Law Institute became more determined to establish the Fund[55] and by early 1945, had reversed its earlier view that an annual statutory declaration was adequate, opting at last for the compulsory audit:

> The Council of the Law Institute ... for five years or more has been almost unanimous that in the interests both of the profession and public it is most urgent that provision should be made for the establishment, immediately after the end of the War, of the fund provided for in the Bill.
>
> The Council has made careful enquiries from time to time of the experience of the Profession in Queensland and New Zealand with the funds that were established many years ago. The information it has obtained shows that the Profession is well satisfied that the existence of the funds is a great benefit both to solicitors and to the public. The Council has not received any information that an annual audit — which in both those countries is compulsory for every solicitor — is either a burdensome expense or a great inconvenience to solicitors...The Council has inquired particularly whether solicitors in the country find special difficulties in obtaining the services of an auditor or in any of the details of audit, and it has not received any information that suggests any serious difficulties occur ...[56]

While the LIV Council may have been increasingly convinced of the necessity for an annual audit, ordinary and, especially country LIV members, were less united, as the 'Letters to the Editor' columns of the Law Institute Journal disclose. A number were in pragmatic support of the audit — and of the Fund — on the basis that although:

> honest solicitors will be paying for the sins of the dishonest solicitor ... the reputation of honest solicitors will, to some extent at least, be protected from the shortcomings of the minority.[57]

Others were less charitable, although by this stage of the debate, more concerned about the cost and inconvenience of the annual audit than the establishment of the Fund per se.[58]

Debate continued throughout 1945, with the LIV using its Journal to justify its commitment to a compensatory fund on the basis of international and interstate developments.[59] Finally, a new Bill was introduced in 1946 and with it the die was cast in favour of compulsory annual audits of trust accounts.

[55] The LIV 'forwarded to every candidate at the 1943 elections a circular setting out its views and recommendations', 'Audit of Solicitors Trust Funds', above n 34, 51.

[56] (1945) 19 *Law Institute Journal* 15.

[57] Letter, CY Syme to the Editor, (1945) 19 *Law Institute Journal* 16.

[58] eg Letter, 'Country Solicitor' to Editor, (1945) 19 Law Institute Journal 37. This practitioner was concerned that the audit would be expensive because the verification of receipts for payments from trust made to farmers would be protracted, as farmers were not in the habit of issuing them! He was also quite clear that a busy practitioner had no option but to rely on a trusted bookkeeper — as true 50 years later as then — and implied that the alternative statutory declaration (still a feature of the LIV Bill at that stage) was also pointless.

[59] eg (1945) 19 *Law Institute Journal* 46, reprinted columns from the *Australian Law Journal* (18 Australian Law Journal 310) and The Scottish Law Gazette (1944 12 Scottish Law Gazette 240–1) referring to the Solicitors Guarantee Funds in Western Australia and Alberta respectively.

Statutory declarations had been discarded, with Mr Slater as Attorney-General and the LIV Council firmly in control of the process.

The Attorney-General described the new Bill on the second reading motion:

> The Solicitors Fidelity Guarantee Fund ... will be established and kept by the [LIV and] ... will consist of annual contributions[60] and levies,[61] the interest that will accrue from the investment of the fund, the monies recovered by the Institute from time to time under the terms of this Bill, and the pecuniary penalties which will also be received ... When the fund reaches £100,000, a provision limiting members' contributions to a period of twenty years will operate ... Finally, the Institute is authorised to use any surplus above the £100,000 mark for benevolent purposes on behalf of aged or sick members of the legal profession.[62]

THE ROUTE TO SELF REGULATION

The Attorney opted for a clean slate approach, requiring solicitors to obtain a commencing audit certificate, with compensation payable for prospective losses only, up to a maximum of £5,000 per defalcation. Part III of the Bill set up the mechanism for these annual audits. Part IV contained the rudiments of the subsequently extensive LIV disciplinary function, which, through the mechanism of the practising certificate, linked the guarantee fund with the right to practise and fundamentally transferred real power in the governance of the profession to its organisational wing.

For the first time, the LIV could *invite* a member accused of misconduct to be disciplined by the Council rather than through the Courts, the member knowing that he would face a maximum fine of only £25 and that his right to practise could not be restricted. Previously, the only course of action open to the Council was to refer such a matter to the Supreme Court, which retained its inherent jurisdiction to discipline members on the Roll. The Attorney (Mr Slater) took advantage of the new Act to increase the dominance of the Council, although not all members of Parliament agreed. Mr Bailey (Warrnambool) spoke up again, criticising any such Council deliberations as akin to a Star Chamber.[63] Nevertheless, the proposal was agreed to after Mr Slater reminded members that the only intention of the provision was to ensure that cases of 'trifling misconduct' which were 'not serious enough to warrant extreme punishment',[64] could be disposed of quickly and privately. In 1946, and for many years afterwards, Parliament was quite comfortable with the notion that solicitors' misdeeds, if minor, could remain behind closed doors.[65]

[60] between £5 and £10 per year; Victoria, *Parliamentary Debates*, Legislative Assembly, 1946, 3558.
[61] up to £10 per year, limited to £50 over the life of the solicitor's practice; Ibid 3559.
[62] Ibid.
[63] Ibid 3945.
[64] Ibid 3946.
[65] Ibid .

Part V of the Bill gave the LIV Council wide rule-making powers, subject to the approval of the Chief Justice. After the fund became operative, no solicitor was entitled to practise without a practising certificate and that could be refused, cancelled or suspended by the Council after due inquiry, subject to a right of appeal to the Supreme Court.

> As the Rules under the Act provided inter alia for the payment to the Institute of a practicing fee and also stipulated that his membership subscriptions should be credited in payment of a member's practising fee without him being required to pay any additional fee, the membership of the Institute increased considerably.[66]

The *Legal Profession Practice Act* 1946 (Vic) (hereafter referred to as *LPP Act*), passed in that year and commenced operation on 1 January 1948. This was the actual beginning of the SGF. Appendix A (below p 154) provides an overview of the key events in its subsequent history. The effect of the Act was not only to create the client compensation mechanism, but also to commence the process of LIV Council control over all solicitors.[67]

While it may be too much to suggest that this control would not otherwise have been secured at some later point in the post-War era, the Council seems to have recognised that the compensation mechanisms could be accompanied by the beginnings of a self-regulatory structure of some power. This fact was not lost on the then Shadow Attorney, the still doubtful Mr Bailey, who reminded the Legislative Assembly that the Supreme Court admitted solicitors to practice, adding:

> Notwithstanding that fact, this Bill provides that a solicitor can only practise after he has applied for a practising certificate. If he is not a member of the Law Institute, his application must be accompanied by an annual fee. Many references to compulsory unionism have been made in this House in the past, but this is compulsory unionism *par excellence*.[68]

So close was the functional and legislative relationship between fidelity compensation and discipline, the LIV was able for many years to stress the protection of the public interest through this combination as the moral justification for its existence as an organisation. In this sense, the defalcation issue was the incubator of legal professional self-regulation in Victoria and for many years the association repaid the profession and the public interest in equal measure. Eventually however, the LIV was to suffer from a diminished ethical awareness in the administration of the Guarantee Fund and, while clients who suffered from solicitor theft have always benefited because of the fund, the LIV became unable to separate completely its own interests from those of the client compensation mechanism. Over decades, the profession slipped into (barely perceived) but chronic conflicts of interests, within that process. In the early

66 'Audit of Solicitors Trust Funds', above n 34, 51.

67 In 1946 there were 1100 solicitors in practice, but 300 of these did not belong to the LIV. All were nevertheless bound by the Act. Ibid 3851. Exclusive LIV control over solicitors was to last for 50 years — 1946–96.

68 Ibid 3850.

1990's these conflicts came briefly into the public eye and, under that scrutiny, prompted the Government to significantly dilute LIV self-regulation.

In a prophetic conclusion to the 1946 Parliamentary debate shortly prior to its initial adjournment in the Legislative Assembly, future experience was foreshadowed in the following exchange between Mr Slater and another member:

> *'Mr Tunnecliffe* — Suppose that there were extraordinary demands on the Fund?
>
> *Mr Slater* — If a crisis did arise, the fund could be augmented by the exercise of the levying power.
>
> *Mr Tunnecliffe* — Probably in the first three or four years a reasonable fund will be built up, but there will be the risks that I have indicated'.[69]

THE DEFALCATION PATTERN

The need for the SGF, and its immediate vulnerability, were promptly demonstrated when two significant defalcations occurred. The first of these concerned NE Wanliss and Miller[70], a firm formed in the early 1940's, and was typical of pre and post-War defalcations in its genesis, development and final outcome. Its story is retold here to emphasise the problems which still beset legal practice in Australia and to signpost the behavioural and legal deficiencies which must still be addressed if the number of defalcations is to be reduced.

Neil Wanliss and Bill Miller met before World War II when both were employed by the firm Green Dobson Middleton. They initially began in partnership as the War escalated, neither being able for health reasons to undertake military service, but then ceased practice (temporarily) when Miller was appointed Victorian Legal Officer of the Civil Construction Corps / Allied Works Council. Miller first noticed Wanliss' fascination with 'two-up' at this time, but thought little of it, given the circumstances of the day.

When the partnership recommenced after the War, they bought the practice of a deceased practitioner (Angus A Sinclair) and Wanliss handled the books on his own. Miller relied on a well respected accountant, Alan Shergold, to conduct an audit. Miller began to notice Wanliss taking quite a few days off and, as Miller recalls it,[71] was aware that Wanliss spent a lot of time at the races on weekends, during the period October 1948 to Easter 1949. When Wanliss simply failed to appear after that Easter, Miller made the following discoveries:

[69] Ibid 3560.

[70] Interview with W H Miller, Consultant, Wisewoulds Solicitors, Melbourne, 4 May 1995. A scenario repeated often since, most recently by Max Green. A partner in the firm Aroni Colman, he stole approx $40m during 1997— much of it arguably placed in his trust but outside the solicitor-client relationship — and was murdered in March 1998. The Age (Melbourne), 25 August 1998, 2.

[71] Ibid.

(1) Wanliss had apparently chosen as victims of his thefts about 6 old clients of the deceased practitioner, all of whom were very trusting and who had left negotiable securities with the firm.
(2) Many of these securities were missing and clients began asking to be paid.
(3) One particular client, Fred Bullen, old and wealthy, owned about 8000 shares in the then Gas and Fuel Corporation. Wanliss forged his signature and sold the shares on the Stock Exchange, insisting on cheques from the broker payable to him personally.
(4) Wanliss had been cycling increasingly larger sums (stolen from these clients) through bookmakers over the 6 months October 1948 to March 1949, culminating in a final and fatal attempt to redeem past losses at the Easter Cup in Sydney.[72]
(5) Total deficiencies came to £30,000.

Miller had totally misjudged his partner, a common and, in itself, forgivable circumstance. A few Saturdays after Easter, Wanliss entered the office and was surprised to be confronted by Miller, who was hard at work. Wanliss left Miller, offering no more than an address care of the Sydney GPO. Miller never saw him again, but was told — years later — that Wanliss, who was part of a distinguished Melbourne legal family, had stayed out of the way in Sydney until shortly before he died, when he returned to Melbourne and expired in a rented room, surrounded by forlorn Tatts tickets.

Meanwhile, Miller was left to face the music. Initially suspected by the LIV of complicity, he was completely exonerated of theft by an LIV auditor. With only a joint interest with his wife in a small cottage, he nevertheless attempted — in the manner common before the SGF commenced — to reach an accommodation with his former clients. This was ultimately successful, and recourse to the SGF, although discussed, was eventually unnecessary. Bankruptcy would probably have preceded an SGF claim and ruined his reputation despite LIV exoneration. It appears he was lucky that those same clients knew him to be honest and had probably been informed that, in 1949, the SGF income had been only 1100 (lawyers) multiplied by (at most) £10!

The recognition that the SGF was no gold mine and was in fact undercapitalised came early to defrauded clients. The second defalcation also occurred in 1949 and should not have allowed for any complacency.

Abbott Beckett Stillman & Gray was also possessed of a partner, Gray, whose true nature was a surprise. Gray had no known vices, was quiet and industrious. He stole about £68,000 and promptly died. No one knew where the money went and, unlike Wanliss and Miller, there was no means of recovery from him.[73] The other partners of the firm were not themselves able to pay. The size of this theft would have meant insolvency for the SGF within two years of its establishment.

[72] Interview with WH Miller, above 70. Wanliss had put £8000 to win on 'Russia', which was beaten by a nose.
[73] Interview with W H Miller, above n 70.

Collapse, however, was not the outcome. Just as many defalcations in the 1930's and 1940's[74] resulted in lengthy negotiations designed to salvage money, SGF administrators from the beginning were conscious of the advantage of delay: the lag between notification of a claim and its eventual payment was and still is inevitable. If the claim were large, significant investigation was necessary to establish its bona fides. If the claim arose as a consequence of the solicitor-client relationship, it was compensable, but if it was as a result of investments where the solicitor acted not as a solicitor but as a financial adviser and intermediary (often the case in claims arising many years later in the 1980's recession), it was not. In Gray's case it took time to establish that the money was simply untraceable. In the interim, the income to the Fund re-established the asset balance and enabled payment on outstanding claims.

In each of the subsequent periods of 'stress' on SGF balances (1963–64 and 1975–76) — except 1994–95 — the 'lag' effect has saved the day. For 45 years the SGF was able to remain solvent as a consequence both of this good fortune and because of another critical factor: the legislative appropriation from the banks of the interest earned on clients' trust balances. The development of this income stream in the 1960's profoundly altered not only the SGF structure but also the nature of the LIV.

The 1950s were a relatively 'sleepy' time for the SGF. Recovering only slowly from the austerity of the 1940s, the economy grew modestly and although solicitors continued to steal, they did so in relative moderation and without particularly serious consequences for the Fund. The LIV received only 10 claims between 1948 and the late 1950s.[75] The 'cap' on payments had been increased gradually from £5,000 in 1948 to £10,000 at the end of 1957, with nine out of the 10 claims being paid in full. Only one payment was limited to £5,000, because most of the relevant losses occurred prior to 1948.[76]

It seemed that Mr Slater's faith in the SGF had been justified, but as the 1961 'credit squeeze' (as it became known to economic historians) took effect, solicitors who had been repeating the old practice of transferring money from one client account to another were first unable to satisfy clients' demands for interest on their mortgage advances and secondly unable (even after receivers had been appointed to their practices) to recover the mortgage capital as the valuations on the secured properties had slumped. A typical defalcation profile, practised very inexpertly by Neil Wanliss in 1948–49 (above) and copied in the early 1960's, involved initial small 'borrowings' from selected clients which were (at first) 'repaid' by the solicitor from other client accounts in a circular fashion. The rotation was theoretically viable so long as the purposes to which the 'borrowings' were put returned enough income to pay interest on the preceding 'borrowing'. The fatal flaw in the process was the breakdown in the income stream caused either by gambling failures or economic recession.

[74] above n 53.
[75] 'Considerable Sums of Money', above n 16, 12.
[76] Ibid.

THE ARTHUR ROW DEFALCATION : 1963–4

Between 1958 and 1964 another eleven defalcations resulted in claims with net payments amounting to £58,000, not including the last and most shocking claim in respect of Arthur Leslie Row, which itself exceeded £100,000. The £10,000 cap was by that time clearly inadequate; six cases resulted in claims which had exceeded the progressive increase in caps — 1948–57 £5,000, 1957–61 £10,000, 1961– £20,000.[77]

AL Row's exploits were significant because, to the commentators and judges of the day, the sheer scale of the theft shocked the community and represented the beginning of widespread public awareness of client vulnerability at the hands of some solicitors. The firm of Row and Mackie operated in inner suburban Bentleigh and Caulfield — one partner per office. Row prided himself on his ability to finance his clients' affairs, and had an early reputation for proficiency. As McGarvie QC (as he then was) told Monahan J in the subsequent Victorian Supreme Court criminal proceedings, Row became vain and protective of that reputation, leading to an initial false step and successive cover ups over 14 months, until final futile efforts on the racetrack to recoup losses in fact resulted in greater ignominy. £25,000 of his total defalcation represented losses to bookmakers.[78] In sentencing Row to the then maximum seven years imprisonment, Monahan J described the losses as 'a figure that takes one's breath away'.[79] Mackie knew nothing of it in the other office of the firm, but — just as Miller had been 15 years previously — he was held responsible. This time however, there was no compromise with creditors and no forgiveness.[80] Mackie was bankrupted. Within days of Row's sentencing the LIV announced that the SGF only had about £80,000 with another £13–14,000 due in November 1964,[81] but claims actual and contingent would exhaust that combined total.[82]

Within months, two other solicitors also caught up in the rash of thefts suffered penalties of imprisonment well in excess of prior cases. First, in December 1964, VG O'Connor (age 46) of St. Kilda was sentenced to 5 years with no minimum term, confirmed on appeal, for stealing £7,000 from his legless Aboriginal client.[83] Secondly, in February 1965, AJ Casey (age 43), also of St. Kilda, stole £12,000 in the context of racehorse ownership, betting failures and forged mortgages. Pape J of the Supreme Court of Victoria said that seven cases of defalcation in the last two and a half years meant that it was desirable that there be no doubt as to the Court's attitude. Casey received eight

77 Mr Wilcox, Victoria, *Parliamentary Debates*, Legislative Assembly, 1964, 1992–1997.
78 'Solicitor Given Maximum 7 Years' Gaol for £86,000 Default' *The Age* (Melbourne), 6 August 1964, 12.
79 Ibid.
80 'Solicitor Admits Deficiency of £125,000: Enmeshed in Web of Misappropriations', *The Age* (Melbourne), 31 July 1964, 5.
81 £10 per solicitor x 1300 solicitors = Annual SGF Income in 1964.
82 'Funds Low in Legal Account' *The Age* (Melbourne), 7 August 1964, 1, 5 (as 'Defalcations "Shock" Legal Profession').
83 '5–Years' Gaol Term Stands: Court', *The Age* (Melbourne), 12t December 1964, 7.

and a half years gaol with no minimum term.[84] By this time, the LIV was able to assure clients that all claims would be paid *in full*,[85] but the LIV and the judges knew they were dealing with horses that had already bolted. The door of the SGF stable had been open too long and was overdue either for closure — which fortunately, no one wanted — or replacement with a much larger building, big enough to contain the financial adventures of the most criminal of practitioners.

LIV President DS Murray had been laying the groundwork with the Government and the public for months. The writing had been on the wall in November 1963, when Row was finally caught. Murray took every opportunity to assure the public that the £400,000 stolen since 1948 should be compared with the £3,000m which had passed safely through solicitors' hands over the same period and reminded everyone that only £100,000 had not been repaid. He urged care not to harm an institution (the legal profession) whose devotion to the rule of law was vital to society's organisation,[86] at the same time continuing with intense negotiations in the offices of the Attorney-General to make sure that the SGF insolvency was laid comprehensively to rest.

WHY NOT LET US APPROACH THE BANKS?

In mid 1963, solicitors in Victoria controlled a 'core' balance of about £26.5m in their trust accounts. The banks paid no interest on these sums because the Reserve Bank had rules which prohibited payment of interest on current (at call) accounts.[87]

It is not clear who first recognised that this interest (then effectively unpayable to clients) was the pot of gold required to recapitalise the SGF. In his article on the SGF for the 1975 LIV Retrospect issue, JA Dawson refers to some anonymous 'concerned souls' who first raised the issue of interest on trust accounts in 1952. He states that the LIV Secretary (Arthur Heymanson) first seriously raised the issue in an internal LIV memo on 19th December 1963, in response to the then impossible load on the fund. He credits RJ Hamer, then Assistant Attorney-General, with active development of the idea, including the suggestion that it finance the administration of trust account audits and professional indemnity insurance in due course.[88] In contrast,

[84] 'Trust Breach Brings 8 ½–Years Gaol: Solicitor Sentenced',*The Age* (Melbourne), 27 February 1965, 10.

[85] Ibid.

[86] 'Solicitors Have Stolen £400,000',The Age (Melbourne), 11 August 1964, 12.

[87] 'Considerable Sums of Money', above n 16, 12. The 'core' balances consisted of the sums considered to be the effective minimum balance levels in each solicitor's trust account. Individual solicitors' balances might vary upward, but were most unlikely to go below the 'core' level. As such, it was prudentially responsible for practitioners to hold a proportion of their core balance in an account with the LIV. This proportion alone (of each solicitor's core balance) earned interest for the SGF.

[88] JA Dawson, 'The Solicitors Guarantee Fund', Law Institute of Victoria — Retrospect: 1947–75 (1975) 49 *Law Institute Journal* 16–17.

Morris Komesaroff (a high profile solicitor who finally joined the LIV Council in the early 1990's) argued (in September 1979) that he and six other practitioners initiated informal meetings of LIV members (on unstated dates) to lobby for the proposal and to oppose the LIV Council, which he described as '... too ready to yield to the expected opposition of the Banks'.[89] Significantly, in the next issue of the Journal, Arthur Heymanson authoritatively stated that Mr Komesaroff was wrong both as to his authorship of the amendment and as to the opposition of the LIV Council. Mr Heymanson asserted that he and Mr Peter Rogers were rebuffed by the Associated Banks in December 1963, and that he suggested in January 1964 that the Council propose the amendments to the Government.[90]

It seems likely that Mr Heymanson, who was aware before Mr Komesaroff of the size of the AL Row defalcation by virtue of his position as LIV Secretary, would have been taking the initiatives he spoke of. Equally, Mr Komesaroff was forever active as a critic of the LIV Council and could conceivably have provoked speed on its part if he were convening informal meetings during the early months of 1964. However it may be, the idea once floated was quickly developed, to the immediate consternation of the banks and then of many Institute members.

The banks at first relied upon the Reserve Bank rules referred to above and confidently rejected LIV approaches. Peter Trumble, subsequent senior partner of Mallesons and LIV President in the critical period at the end of 1963 (continuing in that role until 10 March 1964), changed tack and went to see the State Government. He proposed that:

> Solicitors might be permitted to deposit a portion of their trust funds at call with the Institute which would invest the monies so deposited upon loan to the Government and the interest arising therefrom would be paid to the Solicitors Guarantee Fund.[91]

It was an elegant proposal that sidestepped the banks' defence completely. It was put to the LIV membership at a Special General Meeting on 27 February 1964, along with motions to increase both SGF liability and members' contributions to it. Trumble told the meeting that the Assistant Attorney-General approved in principle and he sought to adjourn the meeting to continue negotiations with the Government.

The Law Institute Journal records[92] that the motions to increase the caps on both member contributions and compensation levels were defeated, as was the adjournment motion. However, the meeting expressed its nervousness by carrying a motion to delay any legislation until all issues had been fully considered and voted upon by LIV members.

[89] Letter to LIJ, 'Have Members of the Institute any Say in its Policies?'(1979) 53 *Law Institute Journal* 489.
[90] Letter to LIJ, 'Mr Komesaroff is Wrong' (1979) 53 *Law Institute Journal* 567.
[91] (1964) 38 *Law Institute Journal* 114.
[92] Ibid.

It was not that members were opposed to taking interest from the banks (at that meeting it seems there was not yet any question as to the propriety or otherwise of payment of interest to clients), for many quickly saw the colour of the bullion; rather there was a fear that it was too good to be true and professional caution emerged (on the night) a convincing winner. The writer of the 'Retrospect' column of the LIJ summed up the feeling eloquently in one sentence:

> This nervousness was not allayed by the disclosure to the meeting of the extent of a recent defalcation, and of a possible weakening in the opposition to provision of funds from some other source, and this chink of light through a hitherto tightly shut doorway was enough to cause the meeting to make for it and to counsel delay while trying to force the door open.[93]

Within a short period a debate ignited which continues to this day. Morris Komesaroff wrote quickly to the LIJ.[94] He equated the whole of the scheme with securing the payment of interest on trust accounts. He was undoubtedly right, as this history will show, for almost all subsequent significant LIV (and some Government) programmes have been underpinned by the SGF cash flow through this interest.

Messrs Komesaroff, R Marsh, R Lewis and W Orr were co-sponsors of the abortive motion (see previous page) relating to interest on trust accounts at the Special General Meeting.[95] Raised alongside them were other voices who returned to the question about the need for any fidelity compensation.

KP Rees wrote to the Journal on 17 March 1964[96] admitting that he had never attended an LIV meeting during 30 years practice, prior to the Special General Meeting. Nevertheless, he asked whether the profession had a duty of any sort to compensate clients for defalcations, wondered if the SGF had prevented or reduced their occurrence and could see no evidence that it had improved the public image of solicitors.

The existence of a *duty* — moral or legal — to organise fidelity compensation, has not been acknowledged by the profession either then or now. While it is not the purpose of this history to argue for such a duty, in early 1995, the then LIV Secretary, Robert Cornall, suggested that this was a serious question.[97] Interestingly, the argument that there is no such obligation is only advanced with any vigour when the fund is insolvent, or nearly so. In the many years since 1964 when the SGF has been in substantial credit, the profession has reminded everyone that the Fund demonstrates the collective commitment

[93] Ibid 130.
[94] Letter to Editor, Ibid 132.
[95] Ibid 132 and also WL Bryan, Letter to the Editor, Ibid 214.
[96] Ibid 133.
[97] Interview with R Cornall, Executive Director, Law Institute of Victoria, Melbourne, June 1995. The existence of a duty to compensate clients is to some extent an academic question only because of the statutory base to the SGF. It is not, however, particularly controversial to maintain that a legal professional organization ought to champion the 'rights' of its members' clients to the recovery of their funds, especially when practitioners are on a daily basis asserting such rights before many forums in respect of the thefts of other professionals.

of lawyers to the protection of the community.[98] In its 'Special Report to Members' of 5 October 1994, when it was still hopeful of containing the SGF $9m deficit (at 30 June 1994), the LIV argued that it should continue to discharge 'regulatory responsibilities' in dealing with claims upon the SGF.[99]

'OWNERSHIP' OF THE FUND

More significant amongst the ethical constraints was the question of ownership, or property in the Fund. Until 1964 the Fund was the trust property of the LIV, to support its client compensatory role. If interest on clients' trust funds was to swell its coffers, the LIV would remain trustee of that interest for the same purpose. Yet this would, of necessity, require an appropriation of money that was earned by clients' deposits with their solicitors. Ralph Burt, then senior partner of Blake & Riggall, was outraged that this interest would be appropriated in any way that might indirectly benefit the profession.[100] For him, this was a breach of trust, even if there were no practical way of accounting to individual clients for the interest earned on their money and no established ethical ruling on the issue. Although it is now arguable that there is a contemporary basis for an 'institutional ethic' (see below App B) which underlies many of the activities of legal professional organisations, and in particular of the SGF, there has never been an established ethical ruling which establishes (such) a duty of an organisation to an individual, group or the community at large.[101] In 1964 Ralph Burt was unable to draw on anything beyond general statements of principle. Burt was also expounding a fundamental law of property: that which belongs to a client continues to do so unless lawfully transferred.[102] It was not just a moral issue and the lack of a calculating mechanism (cost-effective digital computing being a phenomenon of the 1990s) at that time was, in Burt's terms, simply not on point. In his (then somewhat irrational) view, it was better that the interest remain inchoate (though a benefit to the banks) than defined and then applied to this purpose. The credible view that the appropriation of interest under legislation is no different in principle to taxation, was not put explicitly to Burt: but he would not have relented.

Burt spoke up at a meeting of his firm in the strongest possible terms. Allan Cornell, then a junior solicitor with that practice but subsequently LIV President (1982–83) at a time of more major change for the SGF, was at the meeting and remembers Burt as being absolutely unwilling to address the fact that the interest on trust accounts was not going to go to solicitors.[103]

98 Dawson, above n 88. Mr Dawson, himself an ex-LIV President, spoke affirmatively of the 1946 legislation which created the SGF.

99 'Special Report to Members', Law Institute Victoria, 5 October 1994, Para 2.3.

100 Interview with Allan Cornell, Partner, Blakes Solicitors, Melbourne, 8 June 1995.

101 Evans, above n 7, Ch 7, 259, 284–303.

102 Ibid Ch 6, 241.

103 Interview with A Cornell, above n 100. Although Burt was insisting on a point of principle, it is respectfully submitted that he was before his time. There was no point in arguing for the continued inchoate status of the funds when that status could not benefit clients as the equitable owners of the money. The argument does, however, become more compelling when digital computing emerges to make client 'ownership' tangible.

Nevertheless, Burt had his supporters even if they were somewhat half-hearted during the later months of 1964. A correspondent writing on 15 October 1964 to the LIJ stated:

> Whilst it is appreciated that interest on trust monies would be utilised [to support the SGF] and one may say that trust monies are sacrosanct, surely the above would still be of benefit to clients of the profession as a whole.[104]

The fact that the interest could be calculated only with difficulty, together with the recognition that clients as a group would benefit in preference to the banks, was eventually seen in pragmatic and rational terms by most LIV members. A further Special General Meeting was convened on 7 October 1964 and carried the Council's proposals of February 1964 by a majority of 161 to 37. Amongst those in attendance was Peter Ross-Edwards, a future leader of the Victorian National Party, who subsequently recalled the very strong emotions at the meeting. He was not however a detractor, and could not understand why, given that only the banks benefited by inaction, the creation of the special account 'had not been done years before'.[105] Nevertheless, sufficient members were present to request a formal ballot. This was held on 2 November 1964 and resulted in a decisive endorsement, with 842 votes in favour and 152 opposed. So far as the LIV was concerned, the issue was then closed. The LIV proposals moved to Parliament, where momentum was quickly achieved once it became clear that the Government was in support.

PLAY THE BANKS OFF AGAINST THE GOVERNMENT!

The Associated Banks, as they were then known, had initially been quite confident that the LIV proposal was dead in the water. As noted above (see 'Why not let us approach the banks?') the Reserve Bank rule preventing the payment of interest on current accounts had seemed immutable. When the LIV sought to use the Government as its banker and avoid the rule, the Banks immediately approached the LIV and were 'very interested to open up further discussions on the question'.[106] No surprise there. The rapid reversal prompted the then Member for Richmond, Clyde Holding, to speculate that 'the whole purpose of the procedure [to suggest that the Government act as bankers] was to bring the Banks to the party'.[107]

By the time the second reading debate occurred on 1 and 8 December 1964, all the Banks had agreed to pay interest on one third of the lowest monthly balance held by each solicitor in trust for clients, such interest to be paid to the LIV as trustee and controller of the SGF. Mr Holding complained that the LIV[108] negotiations with the Government should have been pursued seriously

[104] BG Hepworth, 'Solicitors' Guarantee Fund' (1964) 38 *Law Institute Journal* 475.
[105] Victoria, *Parliamentary Debates*, Legislative Assembly, 30 November 1976, 5079.
[106] Victoria, *Parliamentary Debates*, Legislative Assembly, 8 December 1964, 2332 (Mr Holding).
[107] Ibid 2335.
[108] Ibid 2332.

by the LIV in the prior months, but his protests were half-hearted. He would have known that, regardless of the possibility of a pre-agreed strategy between the LIV and Government, the latter was conservative, with no intention of pursuing such an agenda.[109]

A revealing exchange between RJ Hamer, then Minister for Local Government, and Labor MLC Mr Tripovich occurred on 8 December 1964 in the adjourned second reading debate in the Legislative Council. Mr Hamer was asked about the so-called 'hardcore' of trust balances held by the banks — the minimum amount which could be said to reside in the total of all trust accounts at any one time. He was at pains to demonstrate that the Bill proposed to use only one third of this 'hard core', and was thus fiscally responsible. He went on to state the central ethical justification for the transfer of interest at that time:

> [The hard core] would be at least £15,000,000. Of course there has been nothing to prevent that money from being placed on fixed deposit provided that it is payable at call, but the difficulty has always been that if it earns interest, the interest belongs to the individual client whose trust monies form part of the money on deposit. It would be necessary *to use a computer* [emphasis added] to work out the entitlement to that interest. So it has never been worthwhile to put any of this trust fund money out by way of fixed deposit.[110]

Given that the interest could not then be feasibly transferred to clients, the next best thing was a desirable public purpose, also clearly seen by Mr Hamer:

> A legal obstacle prevents interest from being earned now and requires the intervention of Parliament to ensure that any interest earned does not go to a solicitor but goes for the benefit of his clients generally.[111]

The Legal Profession Practice (Amendment) Act 1964 (Vic) was passed with new sections 40(2A) to 2(H) to commence on 1 April 1965, the first day of the next trust account year. The maximum compensation level of the SGF was raised to £500,000 and retrospective claims against it were permitted. The other significant change was the decision to allow an innocent partner to claim on the fund to the extent of his losses. Retrospective operation and innocent partner indemnity were clearly designed to cover AL Row's depradations (above, 'Arthur Row Defalcation: 1963–4'), and have never been seriously challenged.[112]

[109] The Government spokesman in the Legislative Assembly, Mr Wilcox, asserted strenuously that the Government had never intended to be banker to the LIV on 'separation of powers' grounds, arguing that trouble results from allowing the Government to interfere with the legal profession — Ibid 2336.

[110] Ibid 2290 (RJ Hamer). See also nt 87, which explains the concept of 'core' balances.

[111] Ibid 2292.

[112] Note however, Mr Holding's view that innocent partner indemnity would promote a lax attitude amongst partners —Ibid 2334 & 2338 — but this seems hard to agree with because few deceived partners have demonstrated casual work practices. The essential ingredient in a partnership is mutual trust, and it is at this level that fundamental misjudgments appear to have occurred. Note, for example, the apparent utter reliance of the firm of Aroni Colman on the integrity of its subsequently disgraced and murdered partner, Max Green, during 1997–98.

The sophisticated use of clients' interest achieved by the 1964 Act was undoubtedly a proper use at the time, and was seen to be so in other Australian states. The AL Row defalcation crisis was disposed of and attention turned, over the next few years, not to the income side of the SGF balance sheet, but to its expenditure.

As the fund re-established its liquidity, fears receded. At some point thereafter, familiarity with this liquidity meant that an understandable comfort level developed around the SGF structure, sowing the seeds of a dependency which led inevitably to successively more severe crises in each of the next three decades.

STATUTORY BENEFICIARIES

It was obvious by 1966 that the interest earned on clients' funds was more than adequate for defalcation compensation. Thefts continued, but were unremarkable in size. Reserves were seen to be emerging, but there was no real suggestion that they should be accumulated and in hindsight — with only one significant SGF crisis to that date — the SGF Management Committee[113] could not have been expected at that stage to anticipate further cataclysm. The emphasis turned to consideration of other desirable public purposes, worthy of support, which became known collectively as 'statutory beneficiaries'. Recipients of SGF money may be described as 'statutory' in the sense that the legislation enshrined their entitlement. In contrast, clients with trust funds on general deposit with their solicitors might be considered 'moral' or 'ethical' beneficiaries although they have had no enforceable rights to the interest earned by their funds.

First among the statutory beneficiaries was the body designed to promote research intended to benefit the operation of the legal system. The Victoria Law Foundation (hereafter referred to as VLF) was set up in 1967 for this purpose, and from that year competed with the Legal Aid Committee (then a 'division' of the LIV) for excess SGF funds. The *Legal Profession Practice (Victoria Law Foundation) Act* 1967 (Vic) inserted a new s 55A to the legislation, effectively the first and simplest of the formulas subsequently used to split up this money.

The LIV Council was given discretion to pay SGF net assets in excess of $1m but less than $1.5m to the VLF (80 percent) and legal aid (20 percent). There was also a direction to pay any excess above $1.5m in the same proportions when net assets exceeded $2m.[114]

[113] Control of the SGF had been completely transferred from the full LIV Council to a designated committee by the *Legal Profession Practice (Amendment) Act* 1964 (Vic) s 58.

[114] Surprisingly, the new section left it unclear if the LIV was obliged to pay, and if so, to whom, any excess between $1.5m and $2m. *Legal Profession Practice (Victoria Law Foundation) Act* 1967 (Vic) ss 55A(1), (2) and (5).

Quite quickly it was realised that the weighting in favour of the VLF was over generous as against legal aid. The LIV began to understand that money moved to legal aid would benefit its members — since it would be available through grants of assistance — in effect retaining income from trust accounts that was unavailable as interest on those deposits. While solicitors did of course have to earn this income, too little was available for the purpose. The proportions payable to the VLF and legal aid were varied marginally in 1969. Thereafter, 70 percent of any excess was to go to the VLF and 30 percent to legal aid.

Among the statutory purposes of the VLF is the obligation to support legal education.[115] Accordingly, when postgraduate training commenced in Victoria in 1972[116] its vehicle, the Leo Cussen Institute for Continuing Legal Education (hereafter referred to as LCI), was substantially funded by the VLF.[117]

Contemporaneously, the first increase occurred in the percentage of trust deposits to be held by the LIV. As from 1 June 1972, 40 percent of the lowest trust balances were to be deposited with the LIV.[118] The cause of this percentage increase was government and professional recognition of yet greater demand for (and advantages from) more legal aid, and the SGF 'excess' funds were to be split 50 percent each to legal aid and the VLF.[119]

The creation of the Law Reform Commission in 1973[120] was the last significant structural addition to the list of statutory beneficiaries before the next SGF crisis occurred. The VLF acquired in that year a statutory obligation to fund both the Commissioner's salary and his expenses,[121] and was dependent upon its funding under the *Legal Profession Practice* Act mechanism to do this.

1975–78 : THREE YEARS OF THEFT, INSOLVENCY AND FIRE

In 1975, Betty Bryant, principal of RW Barrie & Co of Queen Street, Melbourne misappropriated $7m.[122] This precipitated the second significant SGF 'crash' and began a triennium in which (in consequence) the SGF operated during a technical insolvency and required the three years 1975–78 to pay

[115] *Legal Profession Practice (Victoria Law Foundation) Act* 1967 (Vic) s 3, inserting s 14(2)(b) to the Principal Act.

[116] *Leo Cussen Institute for Continuing Legal Education Act* 1972 (Vic).

[117] This funding was discretionary for the VLF, but was seen nevertheless as a legitimate obligation.

[118] *Legal Profession Practice (Amendment) Act* 1972 (Vic), s 40(2)(P).

[119] The 1 June 1972 amendment also removed the earlier ambiguity concerning LIV obligations regarding the 'excess' (see note 105). As from that date, the LIV was only obliged to pay any excess (in the new 50/50 split) above $1.5m when that excess actually exceeded $2m in the relevant year. *Legal Profession Practice (Amendment) Act* 1972 (Vic) s 55A.

[120] *Law Reform Commission* Act 1973 (Vic).

[121] *Law Reform Commission* Act 1973 (Vic) s11 (1), (2)–(6).

[122] A world record defalcation at the time, according to Robert Cornall, former Executive Director of the LIV; 'Considerable Sums of Money', above n 16, 13.

out over $10m.[123] Finally, the LIV building in Little Bourke Street was destroyed by fire on 22 June 1978 and arson was confirmed as the cause.[124]

In April 1975, the new LIV Secretary, the then Gordon Lewis, became aware of the extent of the RW Barrie & Co thefts and called the first LIV press conference to reassure the public.[125] It was a difficult task. It was clear that claims, once admitted, could not all be paid immediately and would have to be staggered over several years, with huge interest bills, as income to the SGF permitted.

RW Barrie & Co did not precipitate the same angst as had AL Row in 1963–64, because the interest on clients accounts was available as a backstop in 1975, admittedly over a number of years, to cushion LIV Council concern. What was different, however, was the dependency upon the SGF of the VLF, LCI, the Law Reform Commissioner and of course, legal aid. Pressure on the Government to support legal aid was immediate, including pressure from its backbenchers.[126] Although LIV administration of the SGF and the LIV disciplinary system were 'preferred creditors'[127] and safe from reduction because any net asset excess was calculated after these expenses were met, the LIV was acutely conscious that any inactivity in the wake of the thefts would not sit well with the other beneficiaries, let alone Government, which was paying for the shortfall, especially in legal aid.[128]

RW Barrie's clients were an extensive mixture of investors (lending on mortgage through Betty Bryant), home buyers and litigants, yet most of the thefts occurred because of the mortgage practice, which by its nature operated with individual lenders having no personal contact with Betty Bryant for some months. Mrs Bryant needed only to pay interest to older lenders with the proceeds of more recent borrowings in order to maintain momentum. RW Barrie & Co, as with many defaulting firms since then, were not essentially acting as legal practitioners to these clients, but as investment advisers, doing little more than nominating borrowers and collecting interest periodically.

The LIV was certainly made aware — through a letter to its own journal — that this category of 'legal' practice was the SGF Achilles Heel[129] but it did not, it appears, recognise that fact. Although everyone no doubt hoped that this type of theft was unique, it was clearly a *modus operandi* which remained open for the future. Mortgage business was, it must be remembered, very profitable for some LIV members. It is not too strong to suggest that the prospect of any

[123] Claims and interest due to 900 claimants. David Jones, 'Presidential Address' (1978) 52 *Law Institute Journal* 312.

[124] Comment by Gordon Lewis [Secretary of the LIV], 'Institute Fire' (1978) 52 *Law Institute Journal* 411.

[125] 'Considerable Sums of Money', above n 16.

[126] Unpublished letter from Bruce Chamberlain MLA to Vernon Wilcox 12 May 1975, suggesting that the statutory deposit percentage be raised to 50 percent. Released under FOI.

[127] *Legal Profession Practice Act* 1958 (Vic) ss 52 & 55A.

[128] Interim Report of the 'Special Committee to Consider the Provisions of the *Legal Profession Practice Act* Referring to Auditing and the Administration of the Solicitors' Guarantee Fund', (hereafter referred to as The Special Committee), 'Draft', 8.

[129] Letter by (Mrs) IMB Griffin to the Law Institute Journal headed 'RW Barrie & Co.' (1975) 49 *Law Institute Journal* 495.

significant reduction in members' incomes consequent upon major restrictions on mortgage practice business was then unpalatable to the LIV Council. As the (self) regulator of the SGF, the Council's inaction did leave a question as to its ability to act first in the public interest.

As an interim measure, the legislation was amended to provide, as of 25 November 1975, for the LIV to make progressive payments on SGF claims, and the percentage of lowest monthly balances held by solicitors and required as a deposit with the LIV was raised from 40 percent to 60 percent, effective as of 31 March 1976.[130] Meanwhile, the review of the SGF (which everyone thought prudent) was being discussed, but, it appears, without real awareness of the core issue.

THE DAWSON COMMITTEE

An eminent 'Special Committee' under the chairmanship of Daryl Dawson QC, (later Dawson J of the High Court)[131] was appointed and its membership announced in December 1975, with restricted Terms of Reference.

Clauses (1)–(3) of the Terms of Reference concentrated on audit improvement, Clause (7) upon the possibility of extracting interest on all trust monies invested from day to day, Clauses (8)&(9) upon removal of SGF investment fund limitations, and Clause (10) upon the allocation formula between SGF beneficiaries.

Clauses (4)–(6) and (11) were relevant to the central problem of mortgage practices. Clause (4) called for consideration of LIV control of clients' monies held in Nominee Investment Companies, Clause (5) referred to limiting SGF liability and Clause (6) questioned the desirability of practitioners acting for both mortgagors and mortgagees in the same transaction.

Clause (11) obliquely referred to the mortgage practice conflict as follows:

> 11. To consider the Act generally with a view to obtaining clarification of when a solicitor is acting as a solicitor and to ensure that the liability of the Solicitors' Guarantee Fund does not extend into areas where the Law Institute does not have power to supervise.[132]

THE DAWSON REPORT: PARTIAL RECONSTRUCTION

The Special Committee resolved to deal relatively quickly with Clauses 8, 9 and 10 of the Terms of Reference, as these were probably the least complex, and published its recommendations in an Interim Report in October 1976.[133] It

[130] Legal Profession Practice Act 1975 (Vic) s 40(2A)(b).

[131] The Committee was also known colloquially as the Dawson Committee — see note 128 above for its full title — and consisted of D Dawson QC, (then Solicitor General of Victoria), CH Rennie (ANZ Bank), L Masel (Solicitor), J Collins (Solicitor), DG Neilson (Institute of Chartered Accountants, Australia), JP Fanning (Australian Society of Accountants) and G Lewis (LIV Secretary); (1975) 49 *Law Institute Journal* 486.

[132] 'Special Committee: Terms of Reference' (1975) 49 *Law Institute Journal* 489.

[133] (1976) 50 *Law Institute Journal* 397–8.

was suggested that SGF investment powers be widened, that the VLF receive between 5 percent and 10 percent, and legal aid between 10 percent and 15 percent, of the SGF net income. The remainder of the income was to meet defalcations and any amount not needed for this purpose was also to go to legal aid. Finally, the Committee suggested that the LIV Council have a discretion to pay any surplus in the SGF balance over $3m to legal aid, with a *requirement* to pay to legal aid any surplus in excess of $4m.

The Government accepted all the recommendations of the Interim Report and enacted the *Legal Profession Practice (Guarantee Fund) Act* 1976 (Vic), operating from 1 January 1977. The new SGF structure created an 'Income Suspense Account' (hereafter referred to as ISA), into which all SGF income was to reside, for accounting purposes, pending distribution under the new formula.[134]

The new arrangements[135] were more complex and, unfortunately, rested (at best) on a misplaced confidence. The Special Committee interim report was clearly based on the assumption that future defalcations of the order of RW Barrie & Co would not recur, and that accordingly the real task was to support legal aid and the lesser beneficiaries with the excess income.

It is interesting to note that both the Opposition and the National Party, who remained silent on the key issues raised by mortgage practices, were at one point very concerned about the changes to the allocation formula for moral and ethical reasons, until reassured by the LIV Council that it (the Council) and the Dawson Committee had really got it right. The then Member for Bundoora, John Cain, himself a former LIV President, at first opposed the reversal of allocation priorities in the Bill:

> The Bill provides that the first call on the fund will not be the meeting of defalcations but, instead, legal aid and the Law Foundation ... I reiterate that the fund was primarily created from interest earned on money deposited by clients and invested in a special account in order to meet defalcations. The Bill completely reverses the original priorities ... This is pure expediency in using money to ensure that a base amount is provided for legal aid.[136]

Mr Cain referred back to the debate in 1964 about the appropriation of clients' interest, and reminded Peter Ross-Edwards (Leader of the National Party) of the number of practitioners who were concerned by that development.[137] His comments initially provoked a strong stance by Mr Ross-Edwards, who made it clear that the National Party would not support the Bill 'if there is any possible doubt that claims might not have first call on the fund'.[138]

[134] Evans, above n 7, see Appendix G Section 3, 'Interrelationship of SGF Financial Statements: 1989–90, 1993–4 and 1994–5'. pp 337–349 Explain the sequential relationship of the cash flows between the internal accounts of the SGF.
[135] Ibid 327.
[136] above 105, 5078.
[137] Ibid 5079.
[138] Ibid 5080.

Robert MacLellan (representing the Attorney-General in the Assembly) undertook to provide figures which (he no doubt hoped) would reassure the other parties in the Parliament.[139] He did so the next day and made it clear that the SGF 'rescue plan' was calculated as a package, and was expected to achieve both SGF stability by early 1978 and the continuing needs of legal aid and postgraduate legal training.[140] The implication was clear that the Government would not be backing down.

At this Mr Ross-Edwards became even more heated, confirming that he had been at the 1964 LIV meeting[141] and asserting that:

> One fundamental principle must be got straight. The money invested in the guarantee fund is trust money owned by the public of Victoria ... I suggest that the money should first be provided for meeting the shortage of trust funds. That should be the first and foremost obligation of the fund. If there is a surplus over a certain amount of money ... a percentage could be provided for those other purposes and I would have no objection to that ... I find it incredible that the Law Institute has seen fit to agree to these principles ... It is morally wrong. Originally the purpose of the money was a safeguard against dishonesty by members of the legal profession. Now the first claim on the fund is to be for purposes which are fundamentally the responsibility of the Government of the day ... I believe the legal profession will be put under a cloud by the passing of this Bill.[142]

After stating that the 1964 LIV meeting would have rejected the current proposals outright, Mr Ross-Edwards offered his political allies a chink in his armour with the comment: 'If it is possible to get the Government off the hook and to provide money out of this fund while safeguarding mortgages, I will go along with it'.[143]

Mr MacLellan, having sensed the opportunity, responded masterfully and was uncharacteristically conciliatory, urging that the Bill be allowed to proceed to the Council on the basis that it not be opposed at this stage, pending further discussions between the Attorney-General and the LIV Council, and consultation with members.[144]

Mr Ross-Edwards, sought to formalise a meeting with the Attorney and remarked perceptively:

> The Law Institute obviously has come to some sort of arrangement with the Government, and it does not have much to offer. It wants the money for legal education and for the Law Foundation. The only way in which it could get it was to do this — shall I say — deal. Therefore, it is a case of the Government having to give a little ground.[145]

[139] Ibid.
[140] Victoria, *Parliamentary Debates*, Legislative Assembly, 1976, 5239.
[141] 23 Ibid 5240.
[142] Ibid.
[143] Ibid 5241.
[144] Ibid 5242.
[145] Ibid 5243.

This was a key utterance by an experienced lawyer. Legal aid was not then mentioned as an LIV priority, although it would have a considerable attraction to the LIV because most of it was paid back to the profession. However, legal aid was a critical responsibility of the Government, and the more so since SGF support had vanished in the wake of RW Barrie & Co.

It is probable that the LIV-Government alliance within the Special Committee, with each agreeing to jettison the priority previously given to defalcation compensation, was cemented in guaranteed minimum funding for the (LIV created) Law Foundation (and its beneficiaries) on the one hand, and the (non-governmental) subsidising of legal aid on the other.

RJ Hamer, Premier and Treasurer, had written to Mr Wilcox as Attorney-General in mid–1975 making it clear that legal aid should continue to be financed *without* budget support. However, he also considered the dependence of legal aid solely on residual distributions from the SGF to be a 'basic weakness' and put the Attorney on notice that he wanted it changed, regardless of RW Barrie & Co. His suggestion that the Attorney consider an approach similar to South Australia, under which a fixed percentage of special account deposit interest was earmarked for legal aid, harked back to his parliamentary support for the 1964 breakthrough. Mr Hamer thought that the percentage of minimum monthly balances lodged with the LIV could be increased from 40 percent to 60 percent, to permit a fixed percentage allocation to legal aid.[146] The Premier's views were obviously persuasive for the percentage did of course rise to this in 1976 (see 'The Dawson report: Partial reconstruction' above) and a fixed percentage (of sorts) for legal aid was introduced[147] — the start of the so called 'three bites' formula (see 'Competing Interests' below). It is however unclear how the Special Committee settled on the exact form of its recommendations insofar as the formula was concerned.

The Special Committee had the opportunity to confirm and strengthen the priority of fidelity compensation, but avoided a focus on underlying cause, or reserve creation, reversing course in favour of the statutory beneficiaries and losing the opportunity to stabilise the fund. How then was this (in Ross-Edwards' terms) 'morally wrong' reversal sanctioned and legitimised?

By the time the Bill reached the Legislative Council, the National Party and the Opposition (no longer of course represented in that place by the sceptical Messrs Cain or Ross-Edwards) were in support. Both parties had been persuaded that the Interim Dawson report comprehensively laid to rest any fears they might hold as to rights of claimants on the SGF. The National Party said as much in the Council and confirmed that the report, together with the assurances of the LIV Council, were entirely sufficient.[148]

The key justifying factor had been the lucid arguments of the Special Committee, which convinced everyone that the only future effect of the current defalcations (and, by implication, any future defalcations) would be to

[146] Letter from RJ Hamer to VF Wilcox, 25 June 1975. Released under FOI.
[147] Evans, above n 7, Appendix D.
[148] Victoria, *Parliamentary Debates*, Legislative Assembly, 9 December 1976, 5760–62 (The Hon SR McDonald (Northern Province)).

delay payment of claims by an estimated six to nine months. Reference was made to the fact that immediate payment was not possible in any event (because of the need for investigation) and that interest would compensate for that delay.[149] Prior statutory nomination of legal aid and the VLF as deserving of continuing funding were cited by the report as evidence of their permanency and status as beneficiaries of the SGF 'whether or not [it] is in deficit'.[150]

THE CONSEQUENCES OF DAWSON

Despite two significant periods of insolvency, the LIV had still to come to grips with the mortal dangers of mortgage practice and the consequential need to accumulate realistic reserves. The new structure was primarily intended to distribute rather than to conserve and operated in this way until it effectively collapsed in 1995.[151] The Special Committee seems to have been confident that interest rates would never significantly decline and that the 'lag effect' in the investigation and payment of claims would allow the SGF to meet future large defalcations from delayed interest income.[152] It is not known whether the Committee addressed the possibility that interest rate decline and large defalcations would in future coincide. It is not possible to say how they regarded the significance of that coincidence in the period 1961–63.

These assumptions about interest rates and thefts were not challenged by the LIV. It is speculation, but they appear to have allowed a head-in-the-sand attitude to prevail in the face of the clear recognition that solicitors when acting as financiers were dangerous (see Mrs Griffin's letter to LIJ of December 1975, n 129 above). Nevertheless, the Special Committee did go on to recommend more rigorous audit requirements (leading to a 'surprise' audit programme by LIV trust account inspectors introduced in August 1978).[153] The consequent Mortgage Register and Nominee Company Rules 1977[154] were the closest the Committee was prepared to come to tackling the undesirable temptations presented to some solicitors by a great deal of money.

For the reasons discussed above, the exploits of RW Barrie & Co were not enough to persuade the Special Committee or the LIV either to remove SGF

[149] The Special Committee, Interim Report, above n 128, 9.

[150] Ibid.

[151] Evans, above n 7, Appendix G, Section 2, 'Charts of SGF Cash Flow at 30th June 1992 and 1995', 332–336.

[152] A claim once notified had to be investigated by SGF staff before payment was approved. In large defalcations there are often many intersecting claims and the investigations are complex.

[153] *Legal Profession Practice (Amendment) Act* 1978 (Vic) and Rule 12(2) Solicitors (Audit and Practicing Certificate) Rules 1990. See also (1978) 52 Law Institute Journal 322–4, and (1979) 53 *Law Institute Journal* 163. Note also the view of an experienced Donald (NW Victoria) practitioner, in a letter to the LIJ, that surprise audits alone are not enough and that the LIV should take over all audits of trust accounts; (1978) 52 *Law Institute Journal* 306. This view had been put previously by the LIV itself in a submission to the NSW Law Reform Commission concerning trust accounts. See (1977) 51 *Law Institute Journal* 329.

[154] Promulgated as statutory rules under the *Legal Profession Practice Act* 1958 (Vic) and commencing on 1 January 1978.

compensation for mortgage theft or to remove solicitors from that area of practice. Piecemeal restriction was preferred. A prohibition on solicitors acting for both mortgagors and mortgagees eventually saw the light of day,[155] and although solicitor investment companies were to be regulated by rules made under the *Legal Profession Practice Act* 1958 (Vic),[156] the draft rules were never proclaimed. The Committee had recommended that mortgage investment companies be licensed by the Corporate Affairs Commission under the *Security Industries Act* 1975 (Cwlth), but the Attorney-General apparently preferred the *Legal Profession Practice Act* structure. The last reference to the draft rules appears in the LIJ for October 1979,[157] after which there was no further comment.

The Special Committee was of course attracted to the idea of interest being paid on *all* trust account balances and not just the money held under the statutory deposit process,[158] but the concept was ridiculed in a public submission to the Committee by the representative of the Australian Bankers Association, a Mr Cameron, who described it as 'unhistorical, immoral and . . . impossible to calculate'.[159] For the moment the idea languished in the 'too hard' basket. Of Clause 11, which had quietly raised the possibility of a general enquiry into solicitors acting as financiers, nothing was heard from the Committee.

1979: CONFIDENCE BORN OF AFFLUENCE

With 60 percent of members' lowest monthly balances earning interest for the SGF, the LIV was confident about the future. Its new, complex formula[160] for allocation of surplus monies to beneficiaries came into effect on 1 July 1979,[161] a year after the last of the RW Barrie & Co claims had been finalised. The VLF was to receive between 5 percent and 10 percent, and legal aid between 10 percent and 15 percent of the balance standing to the credit of the Income Suspense Account at 30th June in each year, to be paid to each body by the following 30 September.[162] After these payments and LIV expenses were paid, the balance of the ISA was to be transferred to the Fidelity Account, and from there defalcation claims were to be met and any final balance, after providing a small reserve, was also to go to legal aid.[163]

[155] Clause 6 of the 'Special Committee Terms of Reference', above n 128. *Solicitors (Professional Conduct and Practice) Rules* 1984 Rule 10(6).
[156] See (1977) 51 *Law Institute Journal* 478 and (1979) 53 *Law Institute Journal* 560–1.
[157] Ibid.
[158] See Clause 7 of the 'Special Committee Terms of Reference', above n 128.
[159] Quoted by Mr G Lewis, (as he then was, then LIV Executive Director) to Robert Cornall, former LIV Executive Director and cited in 'Considerable Sums of Money . . .', above n 16, 13.
[160] Evans, above n 7, Appendix D p 326.
[161] The unitary SGF structure was dissolved in favour of administrative 'Income Suspense' and 'Fidelity' Accounts and the SGF commenced to operate on a financial year basis. (1979) 53 *Law Institute Journal* 163.
[162] *Legal Profession Practice (Guarantee Fund) Act* 1976 (Vic) ss 53(7)&(9).
[163] *Legal Profession Practice (Guarantee Fund) Act* 1976 s 53(11).

The LIV, through its President, Bernard Teague (now Teague J of the Supreme Court of Victoria), considered that the tighter audit controls had reduced the possibility of defalcations,[164] and was apparently content that the surprise and random audit provisions made any tougher action (including no doubt an LIV takeover of trust audits) unnecessary.

Recognition of the amount of money to be made from trust account interest was no longer just an intellectual issue. The 'lowest monthly balance' process alone was responsible for nearly $2.5m in income for the 6 months to 30 June 1978, as compared to just $100,000 income from SGF investments.[165] How much more would be available from interest on total trust balances?

By June 1979, the LIV was already publicly critical of the current system of SGF funding, describing it as 'outdated, inconvenient and extremely limited,'[166] and hoping that recommendations it wanted to put shortly to the Attorney-General would mean 'that more money will be available for legal aid.'[167]

In August 1979, the LIJ reported that the LIV Council believed that up to $12m per annum would be available as interest on solicitors' (trust accounts) total daily balances.[168] The Council wanted to abolish the special account provision and substitute arrangements for payment of interest at — eight to nine percent per annum, calculated daily, on the full $200m then residing in trust accounts. Unfortunately, the Attorney-General, Haddon Storey, was reported as unwilling to force the banks to pay under these proposals, and the Reserve Bank was apparently unwilling to permit any extension of interest on current accounts.[169] The banks, of course, did not take up the LIV invitation to seriously discuss any change. At that time, neither carrot nor stick presented itself, and it is curious, with hindsight, that the LIV thought its prospects at that time to be good.

HOW THE BANKS WERE PERSUADED

The 1980s commenced without much fanfare for the SGF: the VLF was relieved of its sponsorship of the Leo Cussen Institute on 30 September 1980, with the latter to be funded by up to five percent of the Income Suspense Account in each year.[170] The 'normalisation' of the SGF income stream was almost complete, and greater certainty for the Leo Cussen Institute was seen as

[164] (1978) 52 *Law Institute Journal* 469.
[165] SGF Accounts, year ended 30 June 1978. (1979) 53 Law Institute Journal 169. This was the first period in which the SGF Committee of Management could see the light after RW Barrie & Co.
[166] Ibid 163.
[167] Ibid.
[168] For accounting purposes, each client's sub-account — known as their ledger balance — within an individual solicitors' trust account, is added to all other client sub-accounts to arrive at a daily balance for that trust account.
[169] (1979) 53 *Law Institute Journal* 403.
[170] *Legal Profession Practice (Leo Cussen Institute) Act* 1980 (Vic) s 53(7A).

feasible. No more huge defalcations had emerged, and within another year the LIV, desiring the funds awaiting collection, had persuaded the Government to increase the statutory deposit to 66.66 percent of lowest monthly balances, effective 1 January 1982.[171]

With statutory deposits operating at or near the maximum income potential, attention returned in 1982 to the interest on the balances held above the minimum 'hard core'. Some $120m to $130m was estimated to reside in trust accounts over and above the $60m 'hard core', on which interest was, to some extent, already paid. These 'residuary balances', which were cost free to the banks, were the glittering prize. It is clear that much more money was available from clients' interest than was necessary to pay fidelity claims.[172] Mr Ross-Edwards had refocussed the LIV Council on the issue in December 1981 in his second reading speech in support of the increase in the statutory deposit percentage.[173] The new LIV President, Allan Cornell, took office in April 1982 and immediately set about trying to recover interest on the residuary balances.[174]

The first of several difficulties was the problem that the money was trust money, and in theory any interest would have to be paid to solicitors and passed on to their clients[175] pursuant to the law of property and of trusts. Unlike 1964, when computational techniques were accepted by all as too 'primitive' to allow calculation of interest on individual client accounts — especially on a daily balance basis — computers were sufficiently advanced[176] in 1982 to allow calculation and allocation of such funds. So, it was not as simple as 18 years previously to organise the transfer.

Fortunately for the LIV and the other statutory beneficiaries, it was still the case that affordable desktop computing and on-line links between solicitor and bank were impractical. In effect, whilst the calculations were possible, their cost was prohibitive.[177] The LIV did not seek to verify or disprove the prohibition although computing was fast developing, enabling the assertion of a 'technology block' which appears to have operated for many years as a reason for inactivity on the issue.[178] At no time since did the LIV accept suggestions that it should arrange for actuarial investigations of the cost-benefit relationships involved in sub-account calculation and allocation.

[171] *Legal Profession Practice Act* 1981 (Vic) s 2.

[172] Evans, above n 7, Appendix G, Section 6, 'Trends in SGF Distributions : 1980–1995', Charts B and C (pp 359 and 362); Section 7, 'Comparison of SGF Income to Payments and Claims to Claims Provisions :1980–1995', Chart B (pp 367 and 369) and Section 8, 'SGF Income Compared with Claims and Claims Provisions' (pp 371–374).

[173] Victoria, *Parliamentary Debates*, Legislative Assembly, 22 December 1981, 5656.

[174] Interview with Allan Cornell, Partner, Blakes Solicitors, Melbourne, 8 June 1995.

[175] 'Considerable Sums of Money', above n 16, 13.

[176] A point recognised by Mr MacLellan in a later speech in support of the subsequent legislation, Victoria, *Parliamentary Debates*, Legislative Assembly, 2 June 1983, 4955–4957.

[177] Allan Cornell, LIV President and principal architect in the push to obtain residual balance interest, was quite clear that the ethical issue was subsumed by the calculation/allocation cost problem. See Julian Gardner, Director of Legal Aid, File note, LACV, 20 July 1982. The probability that costs were prohibitive was a view also shared by Mr MacLellan, Ibid.

[178] Evans, above n 7, Ch 4, 195–6.

Nevertheless, the 'ownership' problem remained, until it was realised that the banks might be 'asked' to make an ex gratia payment calculated similarly to interest, direct to the LIV. This would avoid[179] (although not it would seem, morally resolve) the trustee issue if it was authorised by legislation. The transfer would on this view, acquire the character of a tax, with much of the revenue going to public and quasi- public purposes. As this strategy was reinforced by the then plausible but parochial perception[180] that allocation of interest to clients was prohibited by cost, pragmatism was again successful. Despite the earlier protest of Ralph Burt, there was no reference to the UK device by which at least a significant proportion of interest is paid to clients.[181]

PUBLIC OPINION AND POLITICAL PRESSURE

Further difficulties then presented themselves: the Reserve Bank's opposition to paying interest on current accounts, and the anticipated continuing refusal of the banks to pay. Allan Cornell's approach was to enlist both the notion of public opinion and the reality of political pressure. The Government and the Opposition (through Peter Ross-Edwards) were well known to the banks as in favour of change. Cornell would have implied the likelihood of open parliamentary criticism of bank inactivity. When the eventual breakthrough came in December 1982, Mr Cain, who was by then Labor Premier, had already established an internal joint departmental working party to facilitate the change.[182]

In July 1982, Cornell and the LIV Executive met with representatives of the trading banks and 'canvassed' the matter.[183] Those discussions have not been made public, but in a meeting requested by the Government, Cornell emphasised that he had taken pains to conduct negotiations at a higher level than previously, and that he considered untenable the refusal of the banks to pay for funds (which they had had for no cost) when interest rates were around 18 percent.[184] No doubt he would also have referred to the resulting damage (by denial of additional SGF funds) to the legal system through inadequate legal aid, and the civic duty of the banks in these circumstances. It may be, though it has not been possible to confirm it, that indications were given that the banks' behaviour would in some way be communicated publicly as undermining the legal aid system.[185] It appears that the banks protested — unwisely, it

[179] 'Considerable Sums of Money', above n 16.

[180] Evans, above n 7, Ch 3, 139–143.

[181] The UK has used a tabular method to allocate significant amounts of interest to clients since 1965. Evans, above n 7, Ch 3, 163.

[182] Memo from Howard Nathan, Solicitor-General (now Nathan J of the Supreme Court of Victoria), to an Attorney General's Legal Officer, 4 November 1984, advising of establishment of the working party. Released under FOI.

[183] Letter from A Cornell to LIV members, 25 February 1983, 2. Received by the author as an LIV member.

[184] J Gardner, Director of Legal Aid, File note, 20 July 1982. Sighted by the author in LACV files.

[185] Note however, that John Cain subsequently congratulated Allan Cornell on his success, and referred to 'the commitment to the welfare of the people of Victoria, which [was] very evident in the negotiations necessary to achieve the breakthrough'. Letter J Cain to A Cornell, 2 March 1983. Released under FOI.

is suggested — that the Reserve Bank's restrictions made discussion pointless.[186] Accordingly, Allan Cornell promptly engaged Mark Johnston of the now defunct Australian Bank to prepare a submission to the Reserve Bank on those restrictions.

The groundwork for that submission had been well laid. The Reserve Bank was lobbied by other States also keen to tap into their respective residual balances.[187] Premier Cain had already stated in Parliament that the LIV should pursue the banks, now that it was possible to calculate interest on gross daily balances,[188] and it was possible to point out to the Reserve Bank that banks were already paying interest on trust accounts of trustee companies.[189]

It is likely that the Australian Bank also reflected in the submission upon the economic anomaly represented by the fact that, but for the cost difficulties in sub-account allocation, the interest would long ago have been payable, and that the public interest — in this case, that of the legal aid system — would directly benefit. Given that interest was already being earned on the 'hard core' of current trust balances through the statutory deposit process, it is not hard to envisage a persuasive submission.

THE STRATEGY OF ALLAN CORNELL

In this context, Allan Cornell and Mark Johnston successively visited each of the trading banks. Emphasis was no doubt increasingly placed on the hope of reversal in the Reserve Bank position, and the arguments put previously to the July 1982 meeting were reiterated with greater force. In this connection the style of Allan Cornell must have played a part. He is reputed to make his points quietly but with the conviction of background strength. With no serious defalcations in the media he could and did closely identify legal aid with the public interest. He stated that he hoped to get one bank to pave the way without going back to the Australian Bankers Association, and had initially approached them individually to limit that possibility.[190] He would have been able to convey the impression, and all sources point in this direction, that he was in contact with the Premier, who would be approving any agreement or acting politically if none were forthcoming. In effect, he would have appeared totally in control, with the Government ready and willing to fire the LIV bullets, should that be necessary.

Unlike quite a number of LIV Presidents, Cornell's requirements would appear moderate because of his tone, but the aftertaste was distinctive. The currently high interest rates were ever present in the background. Not surprisingly, he was publicly supported by the Premier, who repeatedly made his

[186] Ibid 2.
[187] Confirmed by the Reserve Bank in its letter to the Australian Bank of 18 January 1983, cited in letter by A Cornell to LIV members, 25th February 1983, 2, above n 183.
[188] Victoria, *Parliamentary Debates*, [Adjournment Debate] Legislative Assembly, 1982, 1013 (John Cain).
[189] Letter from A Cornell to LIV members, above n 183.

views clear.[191] Eventually, in December 1982, Westpac saw 'the train coming' first[192] and commenced serious negotiations. The other banks began to follow, aware that they might otherwise lose trust account business. The Reserve Bank was quickly made aware of this and wrote to the Australian Bank on 18 January 1983:

> [T]he Banks have indicated that they would be prepared to consider entering into arrangements with the relevant law bodies to pay interest on such current accounts with the payment being made direct to the law institution concerned. We are writing to let you know that we do not raise an objection to such arrangements.[193]

In return for the transfer to Westpac of the investment business represented by the Letters of Credit held by the LIV over statutory deposits arising from Westpac accounts, Westpac agreed to pay 7.5 percent per annum (until 31 December 1983) on solicitors trust account *daily* balances. Cornell considered the deal gave the LIV and the community the 'best of both worlds' because 'hard core' interest was retained and (because it was invested by the LIV rather than the trading banks) maximised.[194] At the same time, the lower but still significant rate of 7.5 percent per annum on residual balances had been secured. The relevant interest rate was to be renegotiated annually.

Westpac itself took advantage of the public acclaim which Cornell and John Cain bestowed upon it, and the LIV was not slow to publicise its success[195] and to congratulate Cornell.[196]

John Cain was at first keen to see the residual balance interest placed in a public purposes trust similar to that later established in NSW[197] but Cornell, who was not of course anxious to lose control of the funds, dissuaded him on the basis that the SGF was the best repository in order to better deal with any future defalcations.[198] (In NSW, it is interesting to note that the separate trust arrangement for residual balance interest removed the NSW Law Society from the box seat. It may not be purely coincidental that the NSW Law Society has, unlike Victoria, relied on significant practitioner contributions to its Fidelity Fund,[199] and did not in the early 1990s face the insolvency of its Victorian counterpart.)

[190] J Gardner, File note, above n 184.
[191] See eg (1982) 56 *Law Institute Journal* 632.
[192] Interview with A Cornell, above n 174.
[193] Letter from Reserve Bank to Australian Bank, 18 January 1983, cited in letter by A Cornell to LIV members, 25 February 1983, above n 183, 2.
[194] Letter from A Cornell to LIV members, 25 February 1983, above n 183, 3. Again, the reference to 'hard core' was to the original statutory deposit interest (above n 87), which the LIV did not wish to lose.
[195] Letter from A Cornell to LIV members, above n 183, cited in (1983) 57 *Law Institute Journal* 248–49.
[196] Ibid 371.
[197] Interview with A Cornell, above n 174. Residual balance interest has enabled the high profile NSW Law Foundation to fund numerous initiatives in that State over the last decade.
[198] Ibid.
[199] Evans, above n 7, Ch 3 pp 144–147.

In the final event, a succinct amendment to the *Legal Profession Practice Act* 1958 (Vic) (new s 53(3)(e)) endorsed what in reality remained ex gratia payments under individual bank agreements with the LIV and confirmed that the residual balance interest so obtained went into the Income Suspense Account.[200]

John Cain as Attorney General wrote to his opposite numbers in all other States and Territories with news of the change and encouraged them to support similar moves as a way of funding legal aid,[201] and the initiative was quickly copied. Legal Aid Commission (Vic) requests for additional funding were received more readily,[202] and subsequent SGF performance revealed just how much money was generated in excess of fidelity requirements.[203]

A FATAL ATTRACTION

The decade from 1983–1993 cemented confidence that nothing could go seriously wrong with the SGF. Although there were signals that big defalcations would continue, the extra income stream from residual balances was huge and dampened most worries.

The LIV commenced cyclical negotiations with each of the trading banks for each year between 1983 and 1993, and even though it was always receiving less than market rates from residual balances[204] they remained highly productive. *Ex gratia* payments totalled $1.78m in 1983 and statutory deposits contributed $11.46m. By 1989–90, residual balances interest had increased to $15m and that from statutory deposits to $17m.[205] Although the decline in interest rates after that year was severe, residual balance income exceeded statutory deposit interest[206] and this situation continued. In the year to 30 June 1995, statutory deposit interest totalled $5.6m while residual balances earned $12m.[207] Significantly, it was not until 1993, when questions about LIV stewardship of the SGF began to gather force, that the LIV sought and obtained a further amendment to the *Legal Profession Practice Act* 1958 (Vic) under which the ex gratia mechanism was revised. Thereafter, a bank could not hold a solicitor's trust account unless it held a residual balance agreement with the LIV.[208]

[200] *Legal Profession Practice (Solicitors Guarantee Fund) Act* 1983 (Vic) s 2.

[201] see eg Letter from J Cain to J Berinson — Attorney-General for WA, 21 April 1983, and response from S Doumany, Queensland Attorney-General to J Cain, received 10 May 1983, released under FOI.

[202] See eg Letter from RA Jolly, Treasurer to J Cain, 11 March 1983 which was sent 10 days after *The Age* first announced that the Westpac breakthrough had occurred (The Age (Melbourne), 1 March 1983, 4), although this particular request was granted with reference to the extra income generated by the 1981 increase in the statutory deposit percentage .

[203] Evans, above n 7, Appendix G, Section 7, Chart B p 369.

[204] The *ex gratia nature* of the payments meant that the LIV could never do more than argue and seek to persuade on the issue ; 'Considerable Sums of Money', above n 16, 2.

[205] Evans, above n 7, Appendix G, Section 5, 'Trends in SGF Income : 1980–1995', Chart A pp 354 and 356.

[206] Ibid.

[207] SGF Annual Accounts, 1994–95, LIV, Note 7 to the Accounts.

[208] *Legal Profession Practice (Guarantee Fund) Act* 1993 (Vic) s 7, inserting s 53A.

The change meant yet higher interest because the Banks' market share was at risk unless they reached agreement with the LIV,[209] a fact which tends to confirm the view that the LIV saw itself as SGF administrator rather than its trustee, during the years of plenty.

Significant defalcations occurred but did not (at first) unduly distress the LIV. In 1983, the then LIV Executive Director, Gordon Lewis, said that $16m had been paid out in claims since 1975 (in respect of 21 solicitors), but emphasised accurately that this was minuscule compared to $16,000m handled by the State's 5000 solicitors.[210] It did not stop there however. Basil Vassis stole $3.55m in 1985[211] and was sentenced to three years after he voluntarily returned from Greece. Jeffrey Cox lost $6.7m through overly ambitious investments before committing suicide in February 1985[212] and Robert Skinner stole enough to ensure that the Victoria Law Foundation did not receive an allocation from the SGF in 1986.[213] Claims against the Fund totalled $17m in that year.[214]

No move towards centralised auditing was put to or passed the LIV Council, although much activity within the LIV identified audit deficiencies as pernicious and suggested that substantial change would occur.[215] Independent audits were confirmed as unsuccessful in identifying major defalcations,[216] but the Committee of Management was concerned that 'there should not be an overreaction to the problem'.[217] By October 1987 a representative Committee set up by the LIV had reported that audits were indeed the culprit (no mention of mortgage practice business per se)[218] but the LIJ headed its report on the topic with the double message:

> The legal profession is [1] rightly concerned about defalcations, which continue to be a major problem [2] caused by a tiny minority of solicitors[219] (emphasis added).

In retrospect, the continual reminders to the profession that its house was basically in order because only a 'minority' were crooks, was fatally attractive. It seems as if the 'bad apples' were *accepted* as given, and the political will to eliminate the real problem did not exist within the LIV Council. As elected representatives, many were rightly conscious of the risk of too deeply

[209] 'enabling the Institute to achieve significantly higher interest rates this [1994–5] year.' See 'Considerable Sums of Money', above n 16, 2.
[210] 'Solicitors' Funds Pay Out $32m',The Age (Melbourne), 9 March 1983, 4.
[211] Letter from G Lewis to J Gardner, 4 August 1983, in which Mr Lewis confirmed that it was difficult to be precise about the size of distributions to the Legal Aid Commission as a result of the Vassis thefts, but hoped the claims would not be over $6.5 — $7m.
[212] 'Dead Lawyer Lost $6m: Institute',The Age (Melbourne), 22 March 1986, 13.
[213] 'Law Foundation Moves for More Stable Income', (1987) 61 *Law Institute Journal* 145.
[214] Letter from Ian Dunn, President LIV to Members, 28 October 1987, 1.
[215] 'Defalcations : Prevention is the Cure' (1987) 61 *Law Institute Journal* 144, spoke of a representative Committee of Councillors and Staff which was due to report on that exact issue later in the year.
[216] Ibid.
[217] Ibid.
[218] Jonathon Mott, 'Defalcations', (1987) 61 Law Institute Journal 992–3.
[219] Ibid.

offending or limiting the income of their fellow practitioners. In the administration of the SGF, the LIV Council (even in the mid–80s) found it very difficult to confront the essential conflicts of self-regulation.

The then LIV President and current Executive Director, Ian Dunn, was more aware of the need for change but could not apparently take the Council down that path. Disclosing the recommendations of an internal LIV committee on 28 October 1987 he courageously wrote to LIV members on the subject of defalcation prevention, proposing a forum and subsequent Council debate to canvass a number of far reaching reforms. If not for the nervousness of the Council, they may have had a significant impact on the massive deficiencies to come, as the recession of the late 1980s advanced. Appropriate suggestions were made to introduce an auditor training course, and to tighten their qualifying rules. These were adopted in 1990.[220] Further restriction of solicitor-client borrowings was put forward and also eventually introduced.[221]

However, there were also important and perhaps vital suggestions put up by Mr Dunn to the forum on 11 November 1987, only to fade from view. These included:

- A recognition that minor compliance infringements ought to receive less attention than previously, in favour of strengthening the inspectorial function. While client confirmation of transactions was introduced and an ex-police Fraud Squad officer was appointed to head the inspection team,[222] the full potential of this measure was insufficiently recognised. The emphasis remained upon compliance rather than the targeting of firms fitting a defalcation profile.
- Computer based, centralised trust accounting at the LIV as a way of limiting fraud. This idea had been taken seriously inside the LIV for some time, but was not implemented. The Deputy Executive Director and Director of Professional Conduct and Practice, Gerry Glennen, had visited France and was favourably impressed by the French approach to trust audits, which was and is centralised.[223]
- Compulsory reporting by banks, building societies, finance companies *and* other solicitors of suspicious circumstances and transactions.[224]
- Introduction of a summary procedure on good cause to investigate the business affairs of the solicitor's immediate family.

In 1994 the LIV confirmed that it had previously recommended or was preparing to recommend that legislation be implemented to address the last two of these issues.[225] However, the only significant area of reform where

[220] *Solicitors (Auditors and Practising Certificates) Rules* 1990 (Vic), r 8.
[221] *Solicitors (Professional Conduct and Practice) Rules* 1984, r 8, introduced 15 August 1990.
[222] Memo Laurie Neville, Finance Director to Gerry Glennen, Deputy Director LIV, 20 December 1994. 'Initiatives by the LIV to amend Legislation and Rules', provided to the author by the LIV.
[223] Evans, above n 7, Appendix I, pp 420–421.
[224] See for comparison the NSW equivalent: *Legal Profession Regulation* 1994 (NSW), Clause 69.
[225] Memo Laurie Neville, to Gerry Glennen, above n 222.

action did occur concerned solicitors' non-lawyer activities: compulsory disclosure to the LIV of a solicitor's business affairs. The *Solicitors' (Audit and Practising Certificates) Rules* 1990 did provide for an irrevocable authority on the application for an annual practising certificate to enable the LIV to access bank accounts other than those associated with the solicitor's practice. However the rule was cancelled when Counsel advised that it was ultra vires LIV powers.[226]

Collectively, these moves would have helped enormously in claims prevention, but the Council would appear to have initiated too little too late. The real centre of SGF debate in the mid to late 1980s was the competition for its bounty, with a squabble amongst the statutory beneficiaries and the Attorney occupying increasing attention.

COMPETING INTERESTS

In 1984 the Law Reform Commission (hereafter referred to as LRC) was established[227] to formalise and expand the work of its predecessor, the Law Reform Commissioner. Although the Chairman's salary was to come from consolidated revenue — as had that of the former Commissioner — the Victoria Law Foundation (hereafter referred to as VLF) acquired the responsibility, with reluctance, to pay for the Commission's expenses.[228]

In 1986, the Attorney-General, Jim Kennan, critical of the size of VLF reserves, decided that the Chairman's salary would also be paid by the VLF, and the full cost of the LRC was transferred to the VLF on 1 January 1987,[229] whether or not the SGF was in a position to fund the VLF.[230] After this amendment, the income entitlements of the various beneficiaries were as follows:

PRINCIPAL SGF (VIC) BENEFICIARIES : JANUARY 1987

INCOME ENTITLEMENTS

LEGAL AID COMMISSION: 10%; 10–15%; SURPLUS ?	**VICTORIA LAW FOUNDATION** 0–10%	**LEO CUSSEN INSTITUTE** 0–5%
1. 10 percent of interest received on lowest monthly balances deposited wih LIV: *LPP Act* s 53(4)(f)]. 2. 10%–15% of the Income Suspense Account : *LPP Act* s 53(9).	0 percent — 10 percent of the Income Suspense Account: *LPP Act* s 53(1)(c).	0 percent — 5 percent of the Income Suspense Account: *LPP Act* s 53(7a).

[226] Memo from Laurie Neville to Gerry Glennen, above n 222.
[227] *Law Reform Commission Act* 1984 (Vic).
[228] *Law Reform Commission Act* 1984 (Vic) s18(3).
[229] *Legal Profession Practice (Amendment) Act* 1986 (Vic), s 3, inserting ss 53(7), 54(1A).
[230] *Law Reform Commission Act* 1984 (Vic), ss 17 & 18.

3. Fidelity Account surplus beyond $3m (discretionary) and $4m (mandatory) after contingencies (claims known and considered likely) allowed for:		
s 53(11).The LACV received first bite from statutory deposit interest, a min. of 10% of the ISA, and -interest rates and defalcations permitting — part of any Fidelity Account surplus. It had considerably more income than the others, but had little or no 'bottom line' certainty. Each beneficiary recognised that the LACV was most affected by the formula because VLF and LCI received their share before any deduction was made for claims. LACV is the only beneficiary directly affected by *claims* made on the SGF.	The VLF had built up considerable reserves and was obliged to fund the Law Reform Commission as well as its own activities. The Attorney-General was not satisfied with the size of its reserves. It has been suggested that the VLF was not comfortable with the fact that it had to fund LRC activities without being in control of the latter's budget, a point of some substance, and believed its own reserves were accordingly necessary.	LCI was entitled to the least amount from the SGF, which could amount to nothing if the Attorney-General so chose. LCI and VLF were more dependent on this discretion than the LACV, but LCI was also providing a more 'neutral' public service and was less under the eye of the Attorney-General.

The allocation formula was a complex attempt to balance competing interests that became less compliant as the decade advanced. A number of issues, identified here by reference to their themes rather than a strict chronology, emerged over this time:

Lack of Information as to the Size of Claims on the SGF

The VLF and Legal Aid Commission of Victoria (hereafter referred to as LACV) were concerned by the lack of information from the LIV as to the size of possible claims on the fund and as to the interest rates obtained on the 'Westpac monies',[233] even though the LIV considered this latter information to be a 'commercial secret'[234] which had to be protected. If claims experience was high, the LACV share of any Fidelity Account surplus dropped, and the budgeting process was made difficult. To this concern could be added fairly constant doubts about LIV proficiency in calculating its annual contingency for claims notified but not finalised and claims incurred but not lodged (hereafter referred to as IBNL), although these doubts were born of a lack of information from the LIV on the issue. The second category of claims (IBNL) eventually became a major point of contention between the LIV and the then

[231] The SGF structure at that time is represented in Evans, above n 7, Appendix D, p 331.
[232] Interview with Rowland Ball, former Chairman, Legal Aid Commission of Victoria, Melbourne, August 1991.
[233] Interview with Mark Herron, Executive Director, Victoria Law Foundation, Melbourne, 15 November 1994.
[234] Interview with R Cornall, Executive Director, Law Institute of Victoria, Melbourne, June 1995 and see also 'Information on the SGF', LIV, October 1991, 3.

Attorney-General, Jan Wade, in her decision to remove control of the SGF from the LIV.[235]

Amount and Priority of LIV Expenses

All statutory beneficiaries (save the LIV) were irritated with the practice of paying first for the LIV regulatory function, and a number of quasi-regulatory expense categories which were seen as suspect in trustee / beneficiary terms, before other beneficiaries received their payments, especially when the Income Suspense Account was actually falling.[236] Their criticisms were often forceful but not particularly effective. The LIV was always careful to reject criticism and to make it clear that its expenditures were authorised by legislation.

Dr Robin Sharwood, Executive Director of the VLF, made plain his scepticism about LIV expenditure in late 1980. He wrote to the Chief Justice, as President of the VLF, (with copies to the Law Reform Commissioner, Leo Cussen Institute and LACV) complaining of the increase in LIV 'charges' on the ISA of about $300,000, at a time when gross income (1979–80) had fallen by nearly $3/4 million:

> It seems to me very hard to justify a situation in which the Law Institute markedly increases its income from the account during the course of a year in which the level of the account is actually falling. Other beneficiaries of the account have their possible income cut *pro rata* if the credit in the account falls. Why should not the Law Institute be in the same position?[237] (emphasis in the original).

In a subsequent memorandum to the other statutory beneficiaries, Dr Sharwood described the breakdown of LIV charges as 'interesting', commenting that while Mr Lewis (LIV Executive Director) had told him that the educational programmes undertaken under s17(A)[238] — not the management advisory services — were intended to be self supporting, 'in fact they appear to have been subsidised to the extent of $233,854 which is a larger subsidy than that which went to the Management Advisory Service'.[239]

Peter Trumble, then Mallesons' senior partner, a Law Foundation member and a former LIV President, was called in to pour oil on troubled waters. He met with Mr Lewis and then wrote to Dr Sharwood that he felt assured that

[235] Evans, above n 7, Appendix G, Section 4, 'Summary of Key Account Results over the Years 1991–2 to 1994–5', Chart E, pp 350 to 353. See also Appendix J pp 433–442.

[236] eg, In 1979–80, LIV expenses rose from $942,000 to $1,242,684 although the Income Suspense Account had declined from $7.65m to $6.9m; SGF Annual Report and Accounts 1979–80. See Evans, above n 7: Appendix G, Section 2, 'Charts of SGF Cash Flow at 30th June 1992 and 1995' (332–337) sets out the cash flow. Note that the LIV share ('Fund Expenses') was calculated and paid first although the charts list recipients in order of the size of their shares.

[237] Letter to Young CJ, 8 September 1980, sighted in LACV files by the author.

[238] *Legal Profession Practice Act* 1958 (Vic) S 17A(1) provided that the LIV should promote 'the use by solicitors of efficient methods of accounting and office managemen ... and increase their competence in the practice of the law.' S 17A(2) stated that the LIV 'shall have power to do all things necessary or expedient...[to achieve S 17A(1)] ... [including power to] ... — (a) arrange training and educational programmes ... (b) publish and distribute information ... (c) advise and make recommendations to solicitors'.

[239] VLF Memo to SGF beneficiaries, 13 October 1980, sighted in LACV files by the author.

'everything is in order'.[240] He was confident that both SGF administrative and s17(A) expenses had plateaued, apart from inflationary pressure, and that an audit regime was in place.[241] Finally, Dr Sharwood wrote to Mr Lewis in terms which, although conceding that a six month audit and nine month projection (of the full year SGF performance) would be of 'great assistance' to the beneficiaries, left an impression that he was unconvinced as to the propriety of all LIV drawings from the fund.[242]

Rowland Ball, LACV Chairman in the late 1980s and early 1990s, and a former LIV President, considered that the LIV was not discharging its responsibilities as a trustee of clients' money in the partial use of SGF funds for libraries, buildings and similar professional development purposes. In a very forceful speech to the 1986 National Conference of Community Legal Centres, entitled 'The Future of Legal Aid', he asserted that the current usage was a breach of an obligation to avoid making a profit from a transaction and to hold all funds on behalf of the beneficiary.[243] These irritations were probably perennial, but were particularly noticeable in years of a declining Income Suspense Account because the LIV share was 100 percent of its requirements[244] while the others were always entitled to less money if that account declined or provision for defalcation claims rose significantly.[245]

In 1990, Elizabeth Loftus, Executive Director of Leo Cussen Institute, asked Robert Cornall for information about LIV expenses deducted from the SGF,[246] but was told that disclosure would be 'premature'[247] and that the LCI should await publication of the SGF accounts. Ms Loftus states that both the LACV and the LCI were concerned by the refusal to explain the expense claims.[248]

Scepticism of SGF Investment Policy

It appears that there was also significant dissatisfaction with LIV financial management of the SGF, ranging from scepticism as to awareness of basic investment policy — eg, the desirability of lending 'long' on a falling interest rate market (seeking longer terms of deposit when rates begin to fall) and vice versa when that market is rising. Again, beneficiaries were concerned because

[240] Letter from PC Trumble to R Sharwood, 16 October 1980, sighted in LACV files by the author.
[241] Ibid.
[242] Letter from R Sharwood to G Lewis, 28 October 1980, sighted in LACV files by the author. See also Evans, above n 7, Appendix G, Section 6, 'Trends in SGF Distributions : 1980–1995'. Chart F (366) shows how LIV expenses paid by the SGF in fact rose steadily during the 1980's alongside periods of low fidelity claims.
[243] See R Ball, Address to 1986 National Conference of Community Legal Centres, June 1986, unpublished.
[244] Until the passage of the *Legal Profession Practice (Guarantee Fund) Act* 1993 (Vic), below 'Minor Legislative Change'.
[245] Evans, above n 7, Appendix G, Section 6, 'Trends in SGF Distributions: 1980–1995', Chart J, pp 360 and 366.
[246] Letter, 4 June 1990, copy provided by E Loftus to the author.
[247] Letter from R Cornall to E Loftus, 8 June 1990, copy provided by E Loftus to the author.
[248] Letter from E Loftus to the author, 20 May 1996.

their own income was directly affected.[249] Doubt that the LIV Finance Committee had itself formulated investment goals in writing, rather than leaving the responsibility to its investment managers, appeared to exist. A perception that SGF investments required daily rates management, but did not receive that high degree of attention, has been noted.[250] Annoyance that big defalcations were not 'picked up', presumably in time to control the blow out of claims, was considerable in the early 1990s. Nevertheless, apart from the basic issue of lawyers' access to mortgage business *per se*, it is likely that this view mainly reflects disagreement with the effective policy of the legislation to exclude non-LIV beneficiaries from SGF management, with the consequent communication blackout except when annual distributions were to occur.

It is of course obvious that no member of the Committee of Management wished to see any defalcations, and gave their time and expertise conscientiously to the management task. The LIV itself, through its Professional Standards department, was to the knowledge of many practitioners including the author, determined in its pursuit of defalcating practitioners: but it is just impossible to identify every permutation of imminent theft. All statutory beneficiaries would have been equally hampered in the job of 'picking' big defalcations, given the policy decision to focus upon audits — and limited compliance-based audits at that — rather than inspections of the centrally dangerous activities surrounding mortgages. The LIV continued to negotiate for *ex gratia* payments from the Westpac monies when rates were rising in the mid 1980s, rather than seeking to entrench LIV power to require commercial rates.[251] This policy does suggest that the LIV may not have been managing the income flow closely, as befits a trustee, until the early 1990s collapse forced that attention.[252]

Tensions Between Statutory Beneficiaries

Antagonism between the VLF and the LRC over their respective budgets and areas of work fuelled the Attorney's financial agenda and spilled out into fairly wide ranging arguments about the 'distributions' side of the SGF.

The VLF had been in the habit of accumulating reserves, which had reached $4.6m by early 1986, to give it some income stability in the face of variable entitlements under its then five — ten percent allocation from the Income Suspense Account. Since 1984 it was also concerned that its statutory obligation to partially fund the LRC was fraught with difficulty because the programme and budget of the latter were outside VLF control. The VLF was in a sense the 'original' law reform organisation in Victoria, predating the Law

[249] LACV Director from 1980 to 1989, Julian Gardner recalls that during the second half of the 1980s, the LACV had a major 'concern' with insufficient monitoring of the SGF earning rate by the Law Department. Letter to the author, 24 April 1996.

[250] Refer to Preface.

[251] As it eventually did in 1993, below 'Minor Legislative Change'.

[252] Evans, above n 7, Appendix G, Section 5, 'Trends in SGF Income: 1980–1995', Chart A pp 355 and 357, and Chart C pp 355 and 358, demonstrate the greater fluctuation in the LIV controlled income ['statutory deposits'] compared with bank controlled 'residuary balance' income.

Reform Commissioner (the antecedent of the Law Reform Commission) by 6 years.[253] The subsequent appearance of the Law Reform Commission as an energetic law reform organisation in 1984 was not just the occasion for dividing the SGF cake among more mouths, but also the advent of a demarcation dispute. The LRC Chairman, Professor David Kelly, was keen to take on research tasks that might otherwise have been left to the VLF. Neither organisation was particularly enamoured of the other, yet they were bound together in a forced (funding) marriage. The only point on which they would have shared common ground was disquiet about the Attorney-General's intention[254] to terminate the transfer of SGF funds to the VLF in the light of the recent Skinner defalcation and the VLF's extensive reserves. When the VLF was compelled to fully fund the LRC without guaranteed recourse to the SGF (above 'The Agenda Becomes Legal Professional Regulation'), it must have been clear to the VLF that it was no longer the favoured son in any sense.

The discussion about VLF reserves widened to include those of the LACV, and appears to have lead the Attorney to consider creating a central SGF reserve — which he would no doubt have preferred because he would control it — in order to finance whichever beneficiary required it, or to fund any other programme or project that appealed to him.[255] Presumably, such a fund would dispose of the need for individual reserves, but would make all concerned — save the LIV — extremely dependent. Inevitably, this line of thought resulted in all other beneficiaries — save the Leo Cussen Institute — appreciating the value of their guaranteed minimum distributions and opposing any Government moves in this direction.

The LACV received most of the SGF excess[256] and would have had the most to lose from a central fund arrangement because its budget was high (in excess of $60m per annum in the late 1980s) and its need to fund new initiatives was continuous and variable. Although its Commissioners considered that they had the Attorney's full support, they were not well disposed to their dollar allocation role being usurped, in practical terms, by the Attorney's office.

The Attorney's push to restructure the SGF began in a memorable meeting on 18 March 1986 between the Law Department (Mr King), LRC (Professor Kelly), LIV (Mr Lewis), VLF (Professor Clark), and LACV (Mr Gardner). Neither LCI (Christopher Roper, Executive Director) nor the LACV was invited, but Mr Gardner decided to invite himself[257] and heard a prolonged

[253] Established by the *Legal Profession Practice (Victoria Law Foundation) Act* 1967 (Vic).

[254] Letter from Attorney-General to VLF, 30 September 1986.

[255] The LACV considered it perfectly likely that the Attorney might wish eg, to fund capital expenditure on courts, or support Court reporting. See Joint Memo from LACV Chairman and Director to Commissioners, 16 April 1986. Note also J Gardner, File note, 20 July 1982, in which he records an exchange between R Ball and H Nathan (as he then was) of the Law Department, in which the latter confirmed that, although the reporting of judgments had been suggested as a possible use for the then 'new' interest on residual balances, it had been decided that if the banks were going to argue that it was 'immoral' to pay the interest, it was even more important to ensure 'that the money be seen as going to legal aid clients'.

[256] Evans, above n 7, Appendix G, Section 6, 'Trends in SGF Distributions: 1980–1995', Chart H p 365.

[257] Letter to author, 24 April 1996.

argument between the others. Mr King was about to open the meeting when Mr Lewis handed him details of the Cox defalcation, then estimated to cost $5.75m. Mr King then indicated that the Attorney wanted the VLF to get rid of its reserves and Professor Kelly — whose LRC budget came from the VLF — made no secret of the fact that he was insulted. The LIV said it was opposed to 'squirreling' funds and Mr King appears to have taken the opportunity to raise the possibility of a complete revamp of the SGF, involving a fixed budget for the VLF — and no 'squirreling'. 'Heated exchanges' followed, with Mr King pointing to the irony of a defalcation compensation fund where defalcations did not have first call upon it. Mr Lewis agreed (at that time) and supported a complete review.

Mr King then switched to the idea of guaranteed annual or perhaps triennial funding for the VLF or LRC, to be soundly rebuffed by Professor Clark on the basis that the VLF needed to respond to 'external preferences' and that a fixed budget would not enable it to plan. Mr Gardner, who was trying to stay 'out of the brawls', privately found this statement difficult to follow, but Professor Kelly insisted that the only agenda for the meeting was the VLF surplus and that nothing else should be discussed. Mr King's statement that the Attorney wanted to reduce the VLF minimum distribution from five percent to zero percent of the Income Suspense Account irritated both professors, Professor Clark making the reasonable point that reduction in the minimum distribution would not reduce the need for a VLF reserve. Mr King did not however submit, returning to the issue of reserves in relation to the LIV ($4m) and that of the LACV ($5m) as well as those of the VLF. He said that he thought that they were really one pool and that somehow they should be used. The 'meeting' adjourned with an agreement for an informal working party to prepare an 'options paper',[258] Mr Gardner wondering whether his lack of prior knowledge of the meeting meant that the LACV was not on the block, or the reverse.[259]

The VLF minimum distribution was reduced to zero percent by the Attorney[260] as foreshadowed by Mr King and no distribution was made to the VLF from the Income Suspense Account in 1986. The VLF argued that it had been unfairly targeted because it had been financially prudent (in building reserves), but to no avail. However, the Attorney did not ultimately succeed with his more radical restructuring, perhaps in part because LIV support for a similar outcome appears to have waned. In a memo from Messrs Lewis and Carmody (Bernie Carmody, then LIV Finance Director) to the other beneficiaries and the Law Department, the LIV reversed its previous position and argued for beneficiary priority over defalcation compensation and declared itself as having no strong view on a central reserve.

[258] Evans, above n 7, Appendix K pp 447–455.
[259] J Gardner, Director of Legal Aid, File note, 18 March 1986.
[260] *Legal Profession Practice (Amendment) Act* 1986 (Vic), ss 3&4. The LRC Chairman's salary (that of Professor Kelly) also became a VLF responsibility instead of a charge on Consolidated Revenue.

The (eventually aborted) Legal Profession Practice (Amendment) Bill 1987 was 'floated' semi-publicly and discussed in early 1987 by all beneficiaries. Its plan was to divide the Income Suspense Account 40 percent to a central reserve (the 'Legal Development and Reserve Account') and 60 percent to the Fidelity Fund allowing the Attorney to allocate all funds to all beneficiaries — save the LIV — with no predetermined annual minimum.[261] It is uncertain how this Bill met its fate or at whose hand, but each beneficiary would have sought to influence the Attorney with whatever argument and whoever was available. The VLF produced a report from one of its staff members (Dr Richard Cullen) in order to set out what it saw as the particularly adverse consequences of the proposals from the VLF point of view. Dr Cullen's report was completed in April 1987 and cogently explained the history of financial uncertainty within the VLF, caused by successive amendments to the legislation. The new arrangements would leave the VLF in a very difficult position if they had no minimum percentage entitlements.[262] This key document was of considerable use to the VLF in its briefing of influential lobbyists and helped to persuade a number of people that the VLF had suffered enough. The most powerful figure in their ranks was undoubtedly the VLF Chairman, the Chief Justice, Sir John Young. Sir John was already well aware of the internecine arguments from the days of conflict between Professor Clark's predecessor, Dr Sharwood, and the LIV. The Bill was withdrawn with no announcement and little ripple; the beneficiaries' scepticism about the LIV role submerging once again.

LACV Confidence As To Its Natural Priority

Despite the much longer history of the VLF as a statutory beneficiary, the LACV considered itself to be the natural priority in entitlement to SGF surpluses. It regarded its activities to be of the most direct public benefit, having precedence over the regulation of the profession (which might be considered a professional rather than a public responsibility) and over the VLF, which appears to have been regarded (somewhat dismissively) by the LACV as only indirectly benefiting the public interest. In fact LACV receipts from the SGF were always the highest of any statutory beneficiary until the early 1990's recession.[263]

LACV Chairman Rowland Ball advocated (before affordable digital computing) the complete expropriation of interest on trust accounts to finance all future legal aid. In the course of his speech to the 1986 National CLC Conference (below, 'Professional Reaction'), Mr Ball commented:

> The Victorian Legal Profession Practice Act actually states that "The funds shall be held in trust for the purposes set out . . . in the Act". This acknowledges that the money and the income from the investment of the client's

[261] The proposed structure is set out at Evans, above n 7, Appendix F, p 324.

[262] R Cullen, 'Victoria Law Foundation: A Financial Conspectus', April 1987, unpublished. See further Evans, above n 7, Appendix K p 448.

[263] Evans, above n 7, Appendix G, Section 6, 'Trends in SGF Distributions:1980–1995', Charts A, D and G pp 358–364.

> money is, in fact, trust money and therefore cannot be appropriated by either the law society or some other body, except in accordance with the Act but in my belief should be used for the benefit of those people whose money it represents, i.e., the solicitor's clients or extending this to some extent to the members of the community who need legal assistance ... The use of the money for libraries, buildings and other law society purposes, not directly concerned with the control and administration of the fund are to my view a misuse of the moneys.
>
> What I call for today is for proper accounting around Australia for the income received from the investment of clients' money held in solicitors' trust accounts and from the money received from the 'Westpac' deal and for this income to be made available for Legal Aid.[264]

The LACV also considered that the Law Reform Commission only indirectly benefited the public and had no dominating claim, while the Leo Cussen Institute ought to be funded by the profession.[265] It was in this context that the LACV was particularly anxious that the Law Department did not understand the SGF formula well enough to comprehend the special position of distributions to legal aid. The LACV Director, Julian Gardner, considered that the Law Department did not sufficiently recognise that:

- the effect of paying the Law Reform Commissioner's salary out of the SGF was to reduce LACV income, 'since otherwise we would have been the recipient of the residue of money in the SGF'.[266]
- legal aid was at the bottom of the list because it alone bore the consequences of defalcations.[267]
- if percentage allocations were entirely discretionary in each year someone else would always be second-guessing the LACV budget, making even short term planning and responses to new legal developments impracticable.[268]
- to the extent that the allocations under the Attorney's proposals would be made by a group consisting of the Chief Justice, the Secretary to the Attorney-General's (Law) Department, the Attorney himself and the LIV President or nominee, they would have a conflict of interest between their role as beneficiaries of the fund 'and now as trustees'.[269]

In each of the above five areas nothing was resolved because no one group, certainly not the Government, held the upper hand. The LIV remained in a pre-eminent position, with all its regulatory expenditure and a number of

[264] R Ball, Transcript of Speech to 1986 National Conference of Community Legal Centres, June 1986, above n 243, 18–19.

[265] Interview with R Ball, Chairman, Legal Aid Commission of Victoria, Melbourne, 1992, specific date unrecorded. See also LACV Internal Memo, A Crockett, Director of Legal Aid to LACV Commissioners, 14 May 1992, sighted in LACV files by the author, which canvasses these views eloquently.

[266] J Gardner, Director of Legal Aid, File note, 18 June 1987, sighted in LACV files by the author.

[267] Ibid. See further Evans, above n 7, Appendix G, Section 6, 'Trends in SGF Distributions: 1980–1995', Charts E and I, pp 363 and 365.

[268] Ibid.

[269] Ibid.

borderline expenses categories such as the LIV Library, funded not by itself but by the interest earned on clients' trust balances.[270] The LACV, as the LIV has pointed out accurately,[271] had the largest financial benefit with $158m received in the years 1982–94, and the Government was relieved of the necessity to find that amount from its own resources.

However, just as the apocalypse overtook many other financial institutions after the stock market crash of late 1987, so also did it overtake the SGF. The great regret about what then occurred was not so much that interest rates fell, for that is episodic, but that defalcation increases were not also expected, although they were also known to be cyclical, and closely related to the years immediately following an economic downturn.

THE BEGINNING OF AN END

The market collapse of October 1987 did not immediately result in the decline of the SGF. Drastic falls in share values at first caused only the corporate sector to revise downward its investment plans, but within two to three years the resulting reduction in the level of economic activity had worked through its 'lag' effect and began to reduce interest rates, which had peaked at an all time high of 18 percent plus in 1990.[272] As Government and the Reserve Bank sought to restimulate an economy that had almost completely stalled, rates continued to slide. The recession was deep, and comparisons were made at times to the Great Depression of the 1930's. By 1993–94, 4.8 percent per annum was the governing interest rate,[273] many businesses had failed, corporate giants had gone to jail or fled to Spain and unemployment was well over ten percent.

Speculative property ventures, which had been aided by Bank lending policies of particular laxity and were a hallmark of the late 1980s, took a particularly heavy toll on investors, including those who invested in both direct and contributory mortgages through solicitors.

SGF income, almost totally dependent on interest rates, went downhill at speed, as did those solicitors who, either for reasons of mismanagement or greed, and having been caught by the rates fall, began to swap funds between client accounts or cut corners in loan practices, in an effort to patch up their growing account deficiencies. Stanley Rosenberg scaled new heights with a reported record theft of $21m in May 1990,[274] updated to nearly $24.7m by the

[270] Victoria, Attorney-General's Working Party on the Solicitors Guarantee Fund, *Report*, (1992), Attachments 3, 7, 12 and, in particular, 13. Attachment 13 (at 36–43 of the report) sets out the format of accounts specified by Report Recommendations 6 and 7 as to the manner in which the Working Party believed that the LIV should disclose the full extent of its reliance upon the SGF. The recommendations were never fully implemented by the LIV.

[271] 'Considerable Sums of Money', above n 16, 14.

[272] Ibid.

[273] Ibid.

[274] 'Record $21m Claim Against Law Institute Fund' *The Age* (Melbourne), 16 May 1990, 1.

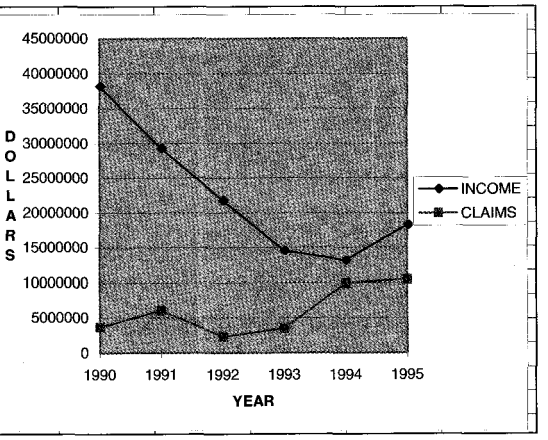
end of the year[275] and, although the subsequent claim was heavily discounted because of losses said to have arisen outside the solicitor-client relationship, the effect of the notification upon LIV and beneficiary confidence would have been considerable. As the subsequent SGF Working Party reported, the eventual $14m Bufalo claim in respect of Rosenberg required a contingency provision of the same amount in 1990 and this produced an identical fall in the funds available to the LACV from the Fidelity Account.[276]

The chart below demonstrates how SGF income and claims payments in the years 1990–1995 pursued mutually disabling paths:

YEAR	INCOME	CLAIMS
1990	38163744	3737764
1991	29317338	6076567
1992	21786815	2304608
1993	14589492	3477099
1994	13182586	9943190
1995	18253276	10441010

SGF(VIC) -- 1990-95 TREND IN TOTAL CLAIMS FOR DEFALCATIONS and TOTAL INCOME

AH Evans [C]-1998
Monash University



CONSUMER CONCERN

The first systematic public criticism of the SGF edifice came from the Consumers' Law Reform Association, a small but vocal organisation based in the eastern suburbs of Melbourne. In April 1991 it published a pamphlet critical of LIV administration of the SGF,[277] and followed upon personal criticisms in *The Age* by the Secretary of the Association, Dale Sedgman, of the then LIV President, Peter Gandolfo, on the uses of the SGF.[278] Mr Gandolfo was displeased, describing the criticisms as 'a slur on the profession as a whole ... [which was also] ... a slur against each one of us as individuals.'[279]

Shortly afterwards,[280] the Federation of Community Legal Centres (Vic) Inc published a pamphlet to support the claims of the LACV to more money from

[275] 'Record Claim Against Solicitors' *Australian Business*, 13 February 1991, 9.
[276] Victoria, Attorney-General's Working Party on the Solicitors Guarantee Fund, Report, (1992), para 7.2, 12.
[277] Consumers' Law Reform Association, *You Should Take It Personally*, (Pamphlet), April 1991.
[278] Dale Sedgeman, Letter to Editor, 'Time to Take Lid Off Solicitors' $35million a year Money Box', *The Age* (Melbourne), 29 December 1990, 10, and Peter Gondolfo (president LIV) Letter to the Editor, 'The Law Determines Which Claim Can Be Met', The Age, 5 January 1991, 12.
[279] (1991) 65 LIJ 229.
[280] Date unknown, but, to the best of the author's memory, probably between April and June 1991.

the SGF.[281] Although more moderate in tone than the Consumers' Law Reform Association pamphlet, it drew clear links between sharply reduced funds to the LACV (on the one hand) and low practitioner contributions to the SGF, low *ex gratia* interest rates on residual balances and LIV expenditure from the SGF, on the other hand.

Public criticism was also reasonably well informed. In a letter of complaint to the Director of Legal Aid, one Melburnian commented in detail on the disparities within the 1990 SGF accounts in relation to differing figures for the LIV and the Professional Standards division of the LIV (hereafter referred to as PS) as separate entities. He asked perceptive questions about the possibility of PS in effect cross-subsidising the LIV in respect of rent, salaries, depreciation and services, and suggested that a review might produce more money for legal aid.[282] Another group with the functional title of 'People for Government Audit of the Solicitors Guarantee Fund', whose membership intersected with 'Law Watch', circulated all Victorian MP's with a long letter, in which it was asserted that:

> (3.) Solicitors who steal hundreds of thousands of dollars from their clients, are treated leniently by the Courts because the theft is refurbished with the public money from the Solicitors Guarantee Fund.[283]

Belief that this connection might hold up was given some superficial credence by the sentencing in December 1991 of Portland solicitor Dennis Newby for theft of $243,000. Newby received a $3000, three year good behaviour bond. The *Sunday Herald-Sun* asked in a feature article if the 'Scales of Justice' had swung 'in favour of crooked lawyers?'.[284] In the article, LIV Executive Director Robert Cornall gave his view that of the nine solicitors who had received bonds for theft in the last three years, only one deserved leniency.[285] The LIV has always strongly advocated custodial sentences for defalcation, and Mr Cornall was also quoted as saying (disapprovingly) that judges often seemed to think that the loss of 'profession, practice and reputation (was) a weighty punishment in itself'.[286] The newspaper however, concluded with the facile comment that the '... (SGF) may also lessen the perceived seriousness of the crime, by reimbursing robbed clients, thereby reducing any chance of a public outcry'.[287] The fact that the LIV was responsible for the whole compensation mechanism and that the community would be very much worse off without the fund could have been mentioned, but was not.

[281] FCLC (Vic),'The Solicitors Guarantee Fund: Public Money or Law Institute Slush Fund', (Pamphlet) 1991, specific date unrecorded.
[282] Letter from D Sargeant to Director of Legal Aid, 20 June 1992, 1–3, sighted in LACV files by the author.
[283] Letter from CM Dickson to J Kirner, MLA, 8 April 1992.
[284] Bronwen Martin, 'The Scales of Justice: Do They Swing in Favor of Crooked Lawyers?' *Newsfront, Sunday Herald-Sun* (Melbourne), 19 April 1992, 29.
[285] Ibid.
[286] Ibid.
[287] Ibid.

Public criticism of the SGF was of course unwelcome to the LIV, which properly considered that it was providing an essential service as efficiently as it could. At times, LIV staff were baffled that it seemed impossible to get adequate recognition for what was an LIV initiative and, because of this, have always felt that LIV use of the fund was legitimate.

Of more practical concern and frustration than newspaper comment, however, was agitation from the statutory beneficiaries.

The Leo Cussen Institute was entitled to no more than five percent of the Income Suspense Account,[288] after provision had been made for all outstanding claims on the fund. In just one year (1990–91), its share dropped by one third from $1.5m to $1.07m[289] and its Executive Director, Elizabeth Loftus, was quick to seek discussions with the then Attorney-General's Department. Her idea was to encourage a limited review for the purpose of maximising its income[290] and solving the Institute's funding plight. However, by the time she had prepared draft Terms of Reference in September 1991, the LACV and VLF had also become concerned and the LIV had announced the first big drop in SGF income since 1980.[291] The decline became quickly entrenched.[292] Her letter to Colin Neave, Secretary of the Attorney-General's Department, reflected a growing wariness:

> Given the comments of other beneficiaries ... and the announcement during the week from the Law Institute of Victoria, I have taken the liberty of including reference to a general review of the [SGF]. The issues outlined tend to reflect common areas of concern and as all the beneficiaries are now feeling the very real problem of a severe reduction in funds this may be the opportunity to air many of the concerns and put into place some generally acceptable changes. [293]

The 'Terms of Reference' drafted by Leo Cussen Institute obviously reflected consultation among the beneficiaries and were a fair representation of most of their earlier misgivings about the SGF. At that stage, LIV involvement was not evident, for there was a fair degree of implicit criticism of the LIV approach. Emphasis was placed upon improvement to administrative and accounting arrangements of SGF operations, risk management techniques and accounting conventions of the Insurance industry in respect of SGF contingent liabilities, a prudential spread of investments across sectors, simplifying calculation of the LACV share, separation of SGF and LRC funding, and interim reporting

[288] *Legal Profession Practice Act* 1958 (Vic) s (53) 7A.

[289] LIV, 'Information on the SGF', October 1994, 6. Although the LACV was the only beneficiary directly affected by an increase in claims , other beneficiaries suffered indirectly because prior year claims increases reduced the balance available to earn interest for the SGF in following years. Reduced income then flowed on to the other beneficiaries

[290] Interview with Elizabeth Loftus, Executive Director, Leo Cussen Institute, Melbourne, 14 December 1994.

[291] Letter from E Loftus to C Neave, Secretary to Attorney-General's Department, 20 September 1991 and 'Information on the SGF', above n 289, 3.

[292] Evans, above n 7, Appendix G, Section 5, 'Trends in SGF Income: 1980–1995', Charts A and B pp 354 and 356.

[293] Ibid.

to beneficiaries.[294] Notable for its absence was any specific reference to the allocation formula between beneficiaries, presumably on the basis that no one wished to revisit the arguments of early 1987 on that issue (see above). Also absent at that stage was the issue of LIV expenditure from the SGF, but it had been raised for inclusion by the time the Department wrote to the LIV President in November, advising her of the establishment of the Working Party.[295]

A LITTLE PROBLEM

An explanation for the insertion of this additional issue lies in the public and political reaction to a spirited but doomed attempt by a suburban practitioner, John Little, to demolish the LIV regulatory structure. In 1986, Little had commenced what became a series of actions in the Supreme Court of Victoria and the High Court to allow him a right of practice without compulsory professional indemnity (hereafter referred to as PI) insurance or a Practising Certificate, both of which were then controlled by the LIV. He refused to pay fees for either insurance or the certificate and on 11th June 1991 was struck off the Supreme Court Roll of Practitioners.[296]

Little described himself as a person of principle who objected to the practising certificate fee because it was fixed for the purpose of allowing the LIV to engage in unauthorised expenditure, namely advertising and the performance of non-statutory functions.[297] He had no convincing argument in respect of his failure to pay for PI insurance[298] and was therefore, by default, conceding the LIV point of view. His argument in relation to the practising certificate fee did, however, find some favour with the Full Court which did not deal with it only because the 'present procedure' — proceedings with a disciplinary purpose — was considered 'inappropriate'.[299] In any event, Little continued his defiance and in June 1991 incurred the wrath of Tadgell J who, upon the application of the LIV, found Little guilty of contempt of the 1988 Order restraining him from engaging in practice. He was fined $10,000, payable within 30 days, in default to be imprisoned until payment was made or until further Order.[300]

[294] Draft Terms of Reference for SGF Working Party, prepared by E Loftus, Executive Director, Leo Cussen Institute, 20 September 1991.

[295] Colin Neave, Secretary of the Law Department, to Gail Owen, President LIV, 6 November 1991, released under FOI.

[296] Law Institute of Victoria, 'Chronology of J Little and LIV', September 1991, unpublished, 16.

[297] third argument in appeal by Little against Order of Nathan J, 15 March 1988 that Little be restrained from practising as a solicitor. Appeal dismissed by Full Court, 8 December 1988, 'Chronology of J Little and LIV', above n 296, 7.

[298] At no stage was there support by commentators or the courts for the view that a solicitor should be permitted to operate without Professional Indemnity insurance in the pressured climate of modern practice.

[299] 'Chronology of J Little and LIV', above n 296.

[300] Ibid 14.

On 1 September 1991, as the SGF beneficiaries were finalising their draft Terms of Reference for the consideration of the Attorney-General, Little was arrested and taken to Pentridge. He was to stay 'inside' for three months until the LIV, aware that it was losing a great deal from the adverse publicity — the theme of which portrayed the LIV as the compulsory cartel restraining the small but honest practitioner[301] — and conscious that its use of practising fees and SGF funds in a co-mingled range of advisory services was very much in the public eye, decided to pull the plug. Early in 1992 a further LIV application to the Supreme Court sought successfully to substitute a fixed term of imprisonment for the previously indefinite detention, and Hampel J released him forthwith, on the basis that a period equal to the specified fixed term had expired.

By then, however, damage had been done to the LIV image. Shortly after Little's imprisonment began, the Liberal MLA for Box Hill, Robert Clark, rose in Parliament in partial defence of Little and, in political terms, guaranteed that the Working Party would be told to consider LIV expenditures in the review.

The Hansard record of his speech on 18 September 1991 was very much to the point:

> The matter concerns allegations made by Mr John Little that the Law Institute of Victoria is misspending income from the [SGF] on the professional standards section of the Institute ... In 1989–90, $3,735,351 was expended from the [SGF] on the professional standards section ... If all that income had to be replaced by fee income from practitioners it would have to be increased by about 140 percent. Furthermore, legal aid is the ultimate beneficiary of any money in the [SGF] that is not expended on other purposes ... [In] 1978 the Act was ... changed to a power to expend money on an advisory service ... and in connection with the performance by the disciplinary tribunal of its functions. [The LIV] argues that the advisory provision — section 17A — has a wide scope which allows the Institute to spend its money the way it does and that the functioning of the tribunal or board includes investigations and preparation for ... hearings.
>
> The power relating to the tribunal or board does not allow for preparations ... In my view section 17A is a fairly narrow provision covering advice and encouragement rather than discipline and rules. However, even on the broadest interpretation I cannot see how it justifies expenditure on the issue of Practising Certificates by the institute. It therefore seems to me that Mr Little is right at least in part in saying that the institute is spending money outside of its statutory authority.[302]

The LIV had proclaimed that it would review its governing legislation, including how members' fees were raised and spent. The Executive Director also said that there might be a review of how the LIV accounted for SGF funds, adding '[i]f Parliament feels that (that) level of accounting is unsatisfactory or no longer the appropriate level of accountability, we would be very happy to

[301] Editorial, 'John Little Case Demands Answers', *The Age* (Melbourne), 18 September 1991, 13.

[302] Victoria, Parliamentary Debates,18 September 1991, 709.

comply with changes that Parliament suggests'.[303] Within another two days, the Law Reform Commission was reported to have decided to review the accountability of the legal profession in a forthcoming 1992 report[304] and the stage was set for an examination of the SGF that, for the first time since the Dawson Committee of 1975–6 (see above), had disturbing implications for the main income stream of the LIV.

In any event the LIV joined the Working Party readily enough.[305] It could hardly do anything else and was fundamentally concerned to deal with the emerging problems.

REPORT OF THE ATTORNEY-GENERAL'S WORKING PARTY: A FINGER IN THE DYKE

At once, the LIV set about preparing itself for likely changes. Apart from its participation on the SGF Working Party,[306] which met from 25 November 1991 until 17 March 1992, its own Professional Issues Committee researched and managed a regulatory debate by the LIV Council over the weekend of 21–22 March, 1992.[307] The SGF Working Party had concluded its deliberations five days previously, and the LIV representatives (Executive Director, Rob Cornall and President, Gail Owen) were clear about its central thrust. Accordingly, the Council resolved that:

- member services would, wherever possible, be self-funding,
- the Finance Committee would examine and report within two months as to possible SGF expenditure savings,
- [in response to the Little debacle] the dual character of the practising fee (under which proportions of same went to regulatory and non-regulatory uses) would remain unchanged, and
- compulsory professional indemnity insurance would also remain.[308]

The following two matters were withdrawn from the list of motions and referred to the LIV Executive:

- that the SGF be audited by auditors appointed by the Attorney-General and

[303] Prue Innes, 'Law Institute to Review its Spending', *The Age* (Melbourne), 18 September 1991, 10.

[304] Prue Innes, 'Law Body to Review Issues Raised by Jailed Lawyer', *The Age* (Melbourne), 20 September 1991, 4.

[305] Letter from R Cornall to D Neal, Director of Policy and Research, Law Department, Victoria, 4 December 1991, released under FOI.

[306] Membership of the Working Party consisted of David Neal (Chair), Acting Director of Policy & Research, Attorney-General's Department; Robert Cornall, LIV Secretary and Executive Director; Andrew Crockett, Director of Legal Aid; Mark Herron, VLF Executive Director; Elizabeth Loftus, Director LCI; Joe Norman, Ministry of Finance; Gail Owen, LIV President; Mike Wilson, Financial Services, Attorney-General's Department; and Richard Wright, Executive Director, Law Reform Commission of Victoria.

[307] Note from J Lynch, LIV Council member to the author, 9 April 1992.

[308] (1992) 66 *Law Institute Journal* 413.

- that SGF practitioner contributions be referred to a special committee.[309]

These two matters were amongst the most sensitive of SGF issues for the LIV, for they directly affected LIV expenditure and income, and neither of them was to be the subject of any recommendation from the SGF Working Party. The LIV therefore had time to consider whether it could avoid major change to either or both practices.

Despite the hopes of Robert Clark MLA (see above) the SGF Working Party at its first meeting decided that it would not consider 'the appropriateness of expenditure from the fund', as it was a group composed of all the beneficiaries and the fund administrator.[310] Of course, it is arguable that this was precisely the group to consider these issues, but the implication that non-LIV beneficiaries had no primary status in the matter of distributions was presumably present. This would have suited the LIV, whose representatives were aware of LIV benefits under those arrangements, but it was apparently also at least the LACV view that the Working Party's deliberations should neither include the issue nor make any reference to it.

Rowland Ball as LACV Chairman attended the first meeting on its behalf.[311] His critical views about LIV expenditure from the fund were well known.[312] At first glance, it is hard to see why he would have agreed with the LIV on the issue of the agenda. Of importance here were the views of Andrew Crockett, LACV Director, who attended all but the first Working Party meeting. Mr Crockett would, of course, also have held the view that the more pressure on the LIV the better, given the volatile position with LACV funding from the SGF. However, he would have received a report of the first meeting from Rowland Ball and appears to have recognised that the Working Party was not the time or the place for acrimony, given the necessity for unanimity of recommendations if any changes were to be effected. He was, however, at pains to ensure that the introduction to the report emphasised that the report expressed no opinion on the detailed expenditure question, and objected successfully to the following statement, which he states was included in the Draft report, but significantly *omitted* from the final version : 'The Working Party accepts that expenditure on the Institute's statutory regulatory functions should be met from the Fund'.[313]

Accordingly, the LACV and each of the other beneficiaries considered that the real agenda for the SGF — expenditure — remained open to each of them

[309] Ibid.

[310] Memo from A Crockett to LACV Commissioners, 14 May 1992, 1, sighted in LACV files by the author.

[311] Ibid.

[312] Mr Ball considered that all advisory services and most regulatory expenses — including the financing of the Solicitors Board and the Lay Observer — were 'trade union' activities which should be funded from members subscriptions. Memo from R Ball to LACV Commissioners, 'LIV Expenses from the SGF', 20 May 1992, sighted in LACV files by the author.

[313] Memo, A Crockett to LACV Commissioners, above n 310, sighted in LACV files by the author.

to pursue with the Attorney-General.[314] This strategy was fortunate for the beneficiaries because the recommendations of the Working Party — while overdue, sensible and productive of more SGF income — added relatively little. Apart from raising the consciousness of all concerned as to the uncertain future of the Fund, the concentration was upon technical and managerial issues.

SPECIFIC RECOMMENDATIONS

To improve the income stream to some degree, the Working Party recommended that the percentage of minimum monthly balances held by the LIV be raised from 66.66 percent to 72 percent on a trial basis.[315] Also, finally recognising that the LIV was not extracting maximum interest from the banks on the residual balances because the whole arrangement was still *ex gratia*, the Working Party stated that the banks should be required to pay interest and restrained from holding solicitors' trust accounts unless interest was payable under an LIV agreement.[316] The Report (at para 3.6, p 6) compared the model of the Estate Agents Guarantee Fund to the SGF as a possible basis for simplifying SGF interest arrangements. The former had abolished statutory deposits in 1989 and substituted a single process of transfer of all interest on agents' trust accounts to its own balance. The Working Party rejected this proposal because the relevant rates were no better than those obtained on SGF residual balances (i.e. less than under the statutory deposits) and would return a lower yield than current SGF 'dual' interest arrangements. Nevertheless, the Working Party hoped that the compulsory agreement regime, which it wished to see introduced in respect of residual balances, would equate residual balance rates to that of statutory deposits. At that time, statutory deposit rates were identical to market rates, whereas residual balances attracted only a percentage of the 90 day bank bill rates.[317]

A minor deficiency in the LIV's oversight of its investment managers was recognised and addressed with a requirement that managers regularly tender for SGF business and comply with specific investment guidelines.[318] These included:

- maximum 18 month contracts with funds managers;
- stated, regular investment strategies;
- clear identification of investment objectives;
- reports as and when required to permit the calculation of monthly results to highlight deviation from expected performance, and to set out the proposed investment strategy for the succeeding quarter.[319]

[314] Ibid.
[315] Report of the Attorney-General's Working Party, Recommendations, above n 276, 17.
[316] above n 276, Recommendation No. 2.
[317] above n 276, para 4.1, p 6.
[318] above n 276, Recommendation No. 4.
[319] above n 276, Attachment 9.

The Working Party noted that in 1989 and 1990 the LIV-managed statutory deposits and its 'own funds' (i.e. the balance at any one time in the Fidelity Account) had not returned interest which was even equal to the 90 day bank bill rate (although the situation was retrieved in 1991); the Working Party said that whether the LIV should have done better was 'open to debate'.[320]

Implied but pointed criticism of the LIV was contained in recommendations effectively to cap LIV drawings for regulatory purposes,[321] which had risen steadily from $1.7m in 1981 to $6.6m in 1991,[322] and to recast the SGF accounts in a form which disclosed LIV expenditure in an accessible manner[323] with adequate descriptive notes.[324] Insurance or a Government Guarantee to safeguard claims liabilities over $7.5m was recommended.[325]

It is interesting that the Working Party recommended insurance as a backstop, as the power to insure against claims was already in the *Legal Profession Practice Act* 1958 (Vic)[326] and the LIV had previously found the premiums too expensive[327] for good reason. The premium would have run to at least seven, perhaps eight, figures. Insurance is financially possible (for insurers) because they can spread the risk of a claim amongst a number of potential customers. In the case of fidelity insurance the sole effective customer would have been the LIV, which could be *guaranteed* to claim from time to time.[328] The difficulty seems self-evident, and perhaps explains why the LIV did not subsequently arrange any policy of this sort. Finally, any accrued funds above $7.5m were to be released to the Income Suspense Account (for the benefit of beneficiaries).[329]

The 'sleeper' among all of these recommendations related to contingent claims. There was long standing suspicion among the beneficiaries that the LIV preferred to overstate contingencies (which meant lower beneficial distributions), and earn further interest on the funds retained after transfer to the Fidelity Account. As the Working Party pointed out 'the Fund has on average retained $19.3m (in each year) when average payments have only been $3.5m'.[330]

The LIV in its defence had asserted to the Working Party with some justification that it was required to provide for all the Fund's contingent liabilities

[320] Evans, above n 7, Appendix G, Section 5 'Trends in SGF Income: 1980–1995'. Chart A pp 354 and 356 and Ch 4 p 181–185 show the less successful performance of LIV controlled funds compared with bank controlled residuary balances.
[321] Report of the Attorney-General's Working Party, above n 276, Recommendation No 5.
[322] LIV, 'Information on SGF', above n 289, 6.
[323] Report of the Attorney-General's Working Party, above n 276, Recommendation No 6 and see also Attachment 13 which prescribed a model format for those accounts.
[324] Ibid, Recommendation No 7. See also Evans, above n 7, Appendix G, Section 9 'LIV Administrative and Other Expenditure', Charts A – K pp 375–384, which shows the LIV expenditure increases and the consequent alterations in LIV expenditure classifications.
[325] Report of the Attorney-General's Working Party, above n 276, Recommendations Nos 9 &10.
[326] *Legal Profession Practice Act* 1958 (Vic) s 53 (4)(a).
[327] Report of the Attorney General's Working Party, above n 276, para 7.5, p 13.
[328] Ibid, para 14.3.
[329] Ibid, Recommendation No 12.
[330] Ibid, para 7.2, p 12.

from the Fidelity Account. This view was both rational and convincing and accepted as such by the Working Party.[331] In other words, unless a claim was obviously untenable, claims and *potential claims known to the LIV* would require a contingency provision. The LIV maintained that it had no choice under the wording of the *Legal Profession Practice Act* 1958 (Vic).[332] The Working Party Report, noting the difference between this requirement and the position of a commercial insurer — 'which can discount more improbable claims'[333] — accepted the implicit LIV view that its provisions for contingent claims were large only because of its statutory obligations. Its recommendation that: 'S.53(11) be amended to require contingent claims to be provided for only when normal accounting practices would require such provision',[334] effectively allowed the LIV to 'head off' beneficiary resentment about 'illicit' reserves.[335] To be consistent with the insurance analogy, and to safeguard against mistakes in the contingency, back up insurance tied to this recommendation was also recommended.[336]

Despite its policy limitations, the Working Party's report was thorough, detailed and extremely well researched.[337] It established the cogency of some misgivings surrounding administration of the SGF while affirming other aspects of LIV performance as trustee. Importantly, the report also created a knowledge base in the Attorney-General's bureaucracy which placed the future Liberal Government in a solid position to make many changes to its structure in subsequent years.

MINOR LEGISLATIVE CHANGE

Regrettably for the LIV, the LACV had its attention drawn to an uncomfortable fact shortly after the SGF Working Party finished its work. In a draft background paper to Legal Aid Commissioners, Andrew Crockett, Director of Legal Aid, commented:

> in 1992/93 for the first time the Institute will draw from the Fund to finance its various activities an amount equal to or slightly more than the amount which is projected to be paid from the Fund for the purposes of legal aid. In the past legal aid has by far been the major beneficiary of the Fund.[338]

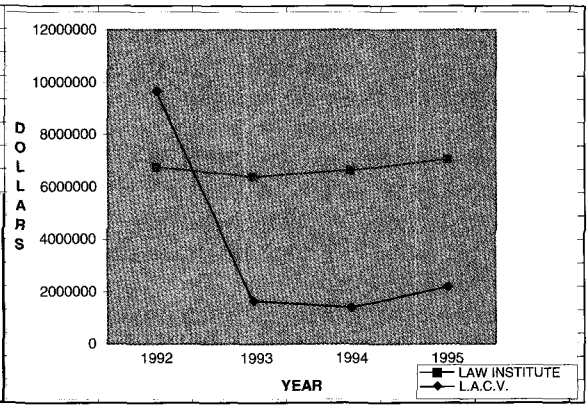
[331] Ibid. As reported by the Working Party.
[332] *Legal Profession Practice Act* 1958 (Vic) s 53(11).
[333] Report of the Attorney-General's Working Party, Recommendations, above n 276, para 7.2, p 12.
[334] Ibid Recommendation No 11. It was on the surface a clear cut recommendation, but the understanding of 'normal accounting practices' came back to provoke further argument three years later (see Evans, above n 7, Appendix J pp 433–443), when the LIV and the Government were barely on speaking terms.
[335] Ironically, in 1994–95, the Liberal Attorney-General subsequently argued that LIV accounting for contingencies was inadequate, and the LIV retorted that it had long sought to create extra *reserves* in the SGF but had been rebuffed by all Governments.
[336] Report of the Attorney General's Working Party, Recommendations, above n 276, No 12.
[337] The only obvious flaw was its statement in the Introduction (para 1.1) that the SGF was established in 1958. It was established in 1946 and began operating in 1949, above 'The Route to Self Regulation'.
[338] Memo from A Crockett to LACV Commissioners, 14 May 1992, 7, sighted in LACV files by the author.

In fact, as the following chart shows, the LIV was to receive *far* more than the LACV. The gap was huge and widened with each successive year as the SGF slipped closer to insolvency:

YEAR	LAW INST	L.A.C.V.
1992	6744515	9652283
1993	6394801	1649295
1994	6622874	1388199
1995	7048406	2181060

SGF (VIC) -- 1992-1995 MOVEMENT IN LIV EXPENDITURE and PAYMENTS TO L.A.C.V.

AH Evans [C]1998
Monash University



The crisis in legal aid funding was obvious. Greg Connellan of Fitzroy Legal Service commented '[i]t has reached the stage where whole areas of law are out of reach for most people',[339] but the LACV Chairman, Peter Gandolfo[340] apparently did not see a crisis:

> 'What has happened is that the community has come to really see the issues ... [this] has focussed attention where it should be, and this is a great opportunity to make changes'.[341]

Mr Gandolfo meant changes to legal aid, which is another story; but minor changes to the SGF were also imminent. In October 1992 the Kennett Liberal Government was elected and Jan Wade, MLA for Kew, was appointed Attorney-General. At that stage, there was no indication of the determined attitude that she subsequently developed towards the LIV. Mrs Wade had no detailed knowledge of the SGF, and could not then see anything contentious in the LIV's wish to clarify its expenditure authority from SGF sources.

The fruit of the SGF Working Party was permitted to ripen, with only a light application of insecticide, in the *Legal Profession Practice (Guarantee Fund) Act* 1993 (Vic). Passed in June, the Act modestly expressed itself as designed 'to make improvements in the structure of the [SGF].'[342] Its principal changes were:

- to increase the percentage of lowest monthly balances (in solicitors' trust accounts) deposited with the LIV, from 66.66 percent to 72 percent, as of 31 March 1994.[343]

339 Peter Gandolfo, 'Legal Aid at Breaking Point', (1993) 67 *Law Institute Journal* 344.
340 LIV President in 1990–91 and on the record with strong and positive views as to the appropriateness of LIV-SGF expenditure — above n 279.
341 above n 339.
342 *Legal Profession Practice (Guarantee Fund) Act* 1993 (Vic), s1.
343 *Legal Profession Practice (Guarantee Fund) Act* 1993 (Vic), s 2 and s 5(1).

- to add a further beneficiary — the 'Law Reform Account' — to the Income Suspense Account — with a *maximum* distribution of 10 percent of that account in each year, provided that total distributions to this new account, to the VLF and to LCI were limited to 15 percent of the Income Suspense Account in each year as of 1 July 1993.[344]
- to cap LIV expenditure from the SGF at the level of the prior year, unless the Treasurer approved an increase, as of 31 March 1994.[345]
- ratification of LIV expenditures on certain activities [which were demonstrated by John Little and others (above p 88) to be outside statutory power], as of 31 March 1994.[346]
- introduction of compulsion into previous *ex gratia* arrangements between the LIV and banks in relation to residual balances, as of a date to be proclaimed.[347]
- audit of the SGF by the Auditor-General, as of 1 July 1993. (This was not a recommendation of the Working Party but the Government determined it was appropriate in any event, given the annual qualification to the SGF Accounts by the Institute Auditor, Mr TA Jones, to the effect that he could not verify that the Banks' calculations as to interest paid on an *ex gratia* basis were accurately *calculated*.)[348]

The increase in Statutory Deposit interest over the years since access was first gained to clients' funds was significant. Increases in percentages occurred when huge thefts temporarily exhausted the balance in the Fidelity Fund and the LIV cast around for ways to quickly increase the income flow. As the following chart shows however, while the need in 1992–93 was most acute, the LIV considered that to go higher than 72 percent would bring the 'core balances' of solicitors under too much pressure. The 'pot of gold' had become uncomfortably light.

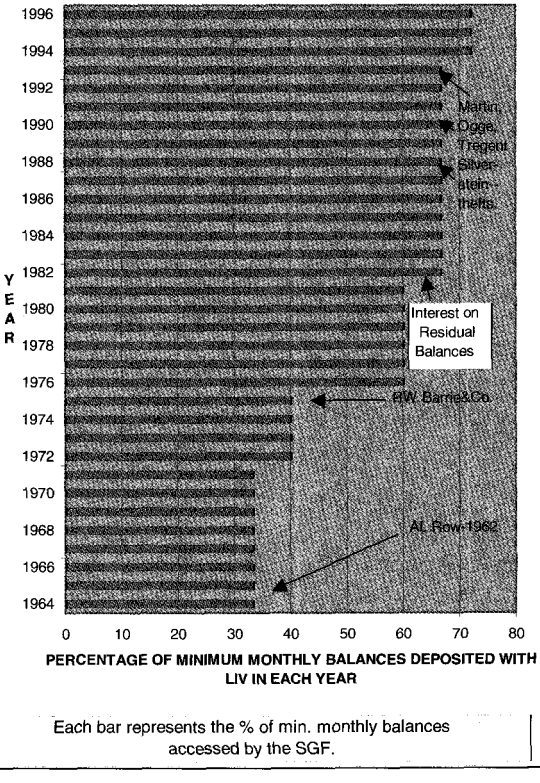
As these changes were being implemented, the LIV itself continued with various internal enhancements of its custodial role. It had heard community and Government concerns clearly, and as an illustration, proposed a voluntary — LIV provided — audit service to members, hoping its lower cost would be attractive and no doubt, that LIV staff auditors would avoid the cosy relationship of private auditors to their lawyer clients.[349] However, the LIV Executive was aware that the Government would in consequence have to make further amendments to the *Legal Profession Practice Act* 1993 (Vic)[350] and the future Government inactivity on this initiative, which was, significantly, opposed by both major accounting bodies,[351] was probably due to the Attorney's

[344] *Legal Profession Practice (Guarantee Fund) Act* 1993 (Vic), ss 2 and 6(1)(6).
[345] *Legal Profession Practice (Guarantee Fund) Act* 1993 (Vic), s 6(5).
[346] *Legal Profession Practice (Guarantee Fund) Act* 1993 (Vic), s 6.
[347] *Legal Profession Practice (Guarantee Fund) Act* 1993 (Vic), s 7.
[348] *LPP (Guarantee Fund) Act* 1993 (Vic) s 6(4) and 'Information on SGF', above n 289, 7.
[349] 'Tackling P.I. Insurance' (1993) 67 *Law Institute Journal* 636; and comment by David Denby, 'Trust Account Audits' (1993) 67 *Law Institute Journal* 1092.
[350] Ibid 636.
[351] Ibid.

PERCENTAGE (%) OF MINIMUM MONTHLY BALANCES (HELD IN SOLICITORS' TRUST ACCOUNTS)& DEPOSITED WITH LIV -- 1964-1996

AHEvans[C]'98
Monash Uni.

1964	33.3
1965	33.3
1966	33.3
1967	33.3
1968	33.3
1969	33.3
1970	33.3
1971	33.3
1972	40
1973	40
1974	40
1975	40
1976	60
1977	60
1978	60
1979	60
1980	60
1981	60
1982	66.66
1983	66.66
1984	66.66
1985	66.66
1986	66.66
1987	66.66
1988	66.66
1989	66.66
1990	66.66
1991	66.66
1992	66.66
1993	66.66
1994	72
1995	72
1996	72



reluctance to make further changes pending her intention (subsequently stated) to review the whole regulatory structure.[352]

THE AGENDA BECOMES LEGAL PROFESSIONAL REGULATION

In a sense, the new LIV awareness of beneficiaries and community concerns in relation to the SGF was too late to convince the new Government. The Attorney-General, Jan Wade, and her Crown Counsel, Greg Craven, had come into power in October 1992 with some misgivings about legal professional regulation. Mrs Wade had been receiving complaints about lawyers whilst in Opposition and expressed her intention to review the current structure.[353] These views were also shared, perhaps with greater determination, by Mr Craven.[354]

[352] J Wade, 'Attorney Cool on National Profession' (1994) 68 *Law Institute Journal* 418.
[353] Telephone discussions with author, specific dates unrecorded, 1992 and 1993.
[354] Interview with G Craven, Crown Counsel for Victoria, Melbourne, late 1993, specific date unrecorded.

In public, the Attorney was circumspect at first[355] and this is probably why the LIV continued with attempts (above p 92) to reduce SGF regulatory expenditure to comply with the new cap and with an attempt to make member services self funding. It seems to have been unable to read the signals that its 'energy saving' moves were not enough for the Attorney or for statutory beneficiaries.

The Attorney had had no input to the 1991–92 Working Party set up by the Labor Attorney-General and was not particularly aware of SGF significance in the early stages of her Ministry. The LIV does not seem to have recognised that the Attorney's hinted investigation of *general* regulation could not be comprehensive unless the SGF was also considered. One can speculate that the LIV — although perfectly well aware of the fact that its own financial viability and position of power over the profession depended on significant SGF subsidies — simply did not ask itself if an Attorney would actually conduct a thorough regulatory review, with or without an SGF quarantine. Perhaps the LIV had in some way divorced its collective thinking on regulation generally from the SGF issue. In any event, its earlier decision to review practitioners' contributions to the SGF (above p 92) — which had seemed to suggest a nascent awareness of the raised guillotine — produced no change, with the status quo in fact staunchly defended during 1995–96 when the Attorney's changes were first introduced (below p 123). Nor was there apparently any move on theft prevention, either by reference to excision of mortgage business from legal practice or the removal of SGF indemnity. The only possible actions to divert the Attorney's course were not taken up.

Consumer lobby groups such as 'Law Watch', a collection of sincere but passionately preoccupied clients who had identified the LIV complaints process as their chief obstacle in obtaining redress from former solicitors, had been active in the Attorney's ear since 1992. Their persistence, which only partially focussed on the SGF, was about to have its effect.

In February 1994, fifteen months after Jan Wade's appointment as Attorney-General, the profession was put on clear notice as to the magnitude of coming changes. In an address to the LIV Council, the Attorney said:

> I think we are going to have to look very carefully at your disciplinary procedures. I recognise that I see this in a particular context: my office is continually besieged with people who have complaints about the legal profession and the Law Institute ... And they are also about in other offices of other members of Parliament. It is an issue we are going to have to look at and resolve ... It is no good the legal profession being happy with the disciplinary procedures if they haven't got the confidence of the community.[356]

[355] See eg, the Attorney General's comment to the *Law Institute Journal* in May 1993, where she indicated that her staff were reviewing a number of reports on the profession, which 'may lead to legislation'. 'Legal Aid at Breaking Point' (1993) 67 *Law Institute Journal* 345.

[356] J Wade, 'Attorney Cool on National Profession', Speech to LIV Council, 17 February 1994; (1994) 68 *Law Institute Journal* 418.

A working party consisting only of Liberal Parliamentary members, business representatives and public servants had already been set up under Mr Craven[357] to review the whole Act. It did not leave the LIV in suspense for long. In June 1994 it released its Discussion Paper entitled 'Reforming the Legal Profession: An Agenda for Change', called for submissions and made it clear that the Attorney's scepticism about discipline extended to all areas of self-regulation:

> A system of pure self regulation in an area as critical to the public as the provision of legal services is unacceptable. The legal profession should be subject to the overall regulation ... of an independent statutory authority, which is constituted with significant lay representation.[358]

When it came to the SGF, a middle road was taken, although still potentially ruinous to the LIV. Recognition that the profession's regulatory role should not permit it to finance purely professional activities from publicly derived funds (the SGF) was stated as a principle[359] and in consequence, control of those funds should be moved to the independent regulator.[360] There was, however, no reference to the debate about *ownership* of SGF monies. The Working Party was no doubt aware that it would have little or no support within the Government for returning interest to clients if it meant finding extra Government money for legal aid.

Curiously, the LIV public reaction was mild and welcoming.[361] LIV President Rod Smith made the politically innocent suggestion that the LIV could now consider concrete reform proposals. He did not however make any immediate suggestions of his own. His rhetoric suggested some confidence that it would all be worked out to everyone's satisfaction, with little obvious awareness that the LIV, for the first time in its 120 year history, was facing a steamroller government.

PROFESSIONAL REACTION

In the year to the end of June 1994 the SGF recorded a deficit, after providing for all contingencies, of just over $9m.[362] The first ever audit of the SGF by the Auditor General in 1994 prompted him to question whether the SGF was

[357] The Legal Profession Working Party consisted of Greg Craven (Chair), Hon James Guest MLC, Dr Robert Dean, MLA, Messrs Robert Clark and Peter Ryan, MLA, Messrs Ian Roach (Roach McIntosh Securities), Paul Ramler (Ramler Furniture and Deputy Chancellor, Monash University), Chris Humphreys (Department of Justice), Rex Deighton-Smith (Department of Business and Employment), Mesdames Jenny Melican and Fiona Hanlon (Department of Premier and Cabinet), and Kirsten Gray (Advisor to the Attorney-General).

[358] Jan Wade, 'Profession Faces Shake-up: Discussion Paper Recommends Radical Change' (1994) 68 *Law Institute Journal* 568.

[359] Ibid 570.

[360] Ibid.

[361] Ibid.

[362] SGF Annual Accounts, year ended 30 June 1994, LIV. *The Age* (Melbourne), 22 October 1994, p 7. See also Evans, above n 7, Appendix G, Section 4, 'Summary of Key Account Results over the Years 1991–2 to 1994–5', Charts A – C pp 350–353, which detail the financial decline and Chart D p 354 which places the 'notional' month in which the Fidelity Account became technically insolvent, as September 1993.

'a going concern', and he sought LIV advice as to 'any strategies in place or contemplated to address the financial position'.[363] This was unprecedented, and consolidated an unreceptive climate within the Government towards responses to the Discussion Paper from the Fund beneficiaries.

The LACV submission in response to the Discussion Paper was delivered in August 1994 and, apart from a short statement of concern that there was no mention of the 'historic connection between the [SGF] and funding for legal aid',[364] made no other reference to the SGF.

The LIV of course devoted considerable energy in its response to what it saw as the key issues of the Discussion Paper and circulated a copy to members as a 'Special Report' on 5 October 1994.[365] This response was reasonably well argued, but in relation to the SGF seemed to lack cogency, and arguably even supported the Attorney's agenda. Thus the complexity of SGF income and claims management was cited as a reason for not 'separating the administration of the Fund from the body handling the regulatory and fidelity roles governing solicitors',[366] as this would be costly and inefficient; but the Discussion Paper and the subsequent Working Party Report advocated the effective removal of both roles from the LIV to other regulators.[367]

Similarly, the LIV suggested that LIV staff expertise about the SGF could not easily be acquired by a statutory agency, omitting reference to the probability of transfer of these staff to that agency.[368] Again, there was silence on the issue of practitioner contributions to the SGF, the LIV taking the view that additional contributions had not been previously raised as an issue, 'probably because the Fund has met and continues to meet its obligations as they fall due',[369] which unfortunately contradicted reference to this point in newspaper correspondence.[370]

The LIV's confidence as to the fund's solvency must have been faltering, however, because there were signs of disquiet amongst some LIV members about the handling of a case involving a large suspected defalcation. In late October 1994, it was reported that a two year LIV delay in investigating and terminating the practice of Mr Romauld Martin of Kew had led to bigger losses (up to $17m) than were otherwise likely. The LIV was reported to have unsuccessfully attempted to place the practice in receivership in 1992, but the delay afterwards was not explained.[371]

[363] Letter from CA Baragwanath, Auditor General to R Cornall, LIV, 6 September 1994.
[364] LACV Response to Discussion Paper, 17 August 1994, Principle 7, p 6.
[365] LIV, 'An Independent Legal Profession — An Integral Part of the Justice System, Special Report to Members', 5 October 1994.
[366] Ibid, Para 2.7.
[367] Victoria, Department of Justice, Report of the Attorney-General's Working Party on the Legal Profession, 'Reforming the Legal Profession', August 1995, Recommendations 1.3.4 (p 28), 1.4.29 and 31 (p 35), 3.3.3 (p 50), 3.4.6 (p 52), 2.3.2 (p 41).
[368] LIV, 'An Independent Legal Profession . . .', above n 365, para 2.7.
[369] Letter from R Smith to the author, 7 November 1994.
[370] Letters to the Editor, Adrian Evans, '20c a Week Not Enough for the Solicitors', Ross Smith, 'State Pays Mere 4% of Legal Aid Costs', *The Age* (Melbourne), 5 January 1991, 12.
[371] Gary Hughes, '$17m Probe: Solicitor Was Not Stopped Practising', *The Age* (Melbourne), 24 October 1994, 5.

Disquiet about the SGF may have led the LIV to begin a last offensive. In January 1995, the LIJ allowed publication of a polemical piece in which LIV past President, David Denby, suggested the complete abandonment of fidelity compensation if the Attorney attempted either to take away control of the SGF or imposed practitioner contributions. At the least — and not before time — he believed that SGF exposure should in some way be limited by removing investment monies from SGF coverage.[372] In the same month, it appears that a document was privately circulated amongst some LIV Council members in which the suggestion was made that, amongst other matters, President Rod Smith and Vice President Mark Woods had 'uncritically supported the Attorney-General's reform plans.'[373]

The document provoked Rod Smith considerably[374] but it is nevertheless likely that some members of Council believed, as did past-President David Denby, that the SGF was becoming more trouble than it was worth. At any rate, a special Council working party chaired by Treasurer Geoff Provis reported to the June 1995 LIV Council meeting in terms which went some way towards support of Denby's views. The working party proposed a Solicitors' Mortgage Group and registration system which would allow a charge on each mortgage to go to the SGF in lieu of the then $10 per annum levy. This idea, coupled with centralised trust accounting, was endorsed by Council,[375] and represented an innovative and worthy initiative. Unfortunately, it was just too late,[376] as events were fast overtaking the LIV.

A VERY DEFICIENT SGF

If the Attorney-General were ever disposed to reconsider her approach to the SGF, the possibilities receded rapidly as 1995 unfolded. Amongst a number of developments the following are noteworthy:

- The Attorney-General wrote to the LIV raising the possibility that mortgage practice defalcations would be excluded from the SGF.[377]
- Police were reported to be investigating 26 Victorian law firms in relation to frauds involving more than $54m. Eleven solicitors were under scrutiny over $38.4m and a further 15 in relation to another $15.8m. In addition, another six firms had been referred to the major fraud group, involving another $3.07m, by the LIV over the past 4 months.[378] In particular Dudley Tregent & Co ($11.6m over 163 claims) was singled out as an example of grossly incompetent mismanagement.

[372] D Denby, 'Freeing up Practice: A deregulator's views on legal reform' (1995) 69 *Law Institute Journal* 7.
[373] 'Natural Justice Prevails: Institute Update' (1995) 69 *Law Institute Journal* 468.
[374] Ibid.
[375] A Vanstone, 'Justice Statement: Vanstone's View' (1995) 69 *Law Institute Journal* 693.
[376] A more generalised approach to SGF financing involving linkage to size and turnover of mortgage practices had been aired in 1991 (see Letter to *The Age* by the author, 5 January 1991, 12).
[377] Letter from the Attorney-General to the LIV, 1 February 1995.
[378] David Wilson, 'Solicitors Probed on Millions', *The Age* (Melbourne), 21 March 1995, 1.

- The LIV seriously suggested a $2m cap on payouts to any one client in respect of SGF compensation[379] and the staggering of payments, implying that it had not been able to provide reserves because of the Government's requirement that it also support legal aid. The LIV disclosed that it had asked Mrs Wade in December 1993 for power to access solicitors' private and family accounts when investigating defalcations, but had not been granted this access.[380]
- *The Age* commented: 'While the move towards regulation may appear to be counter to the philosophical direction of the Government that has moved to deregulate other professions, it seems that lawyers have made themselves a special case'.[381]
- The LIV wrote to all members warning that the Government's proposals to reform the profession (by creation of a separate Legal Practice Board with power to issue practising certificates and define professional rules) threatened the independence of the profession.[382] While LIV President Rod Smith was not quoted as saying that the transfer of control of the SGF to the proposed Board was a risk to that independence, he did say that the SGF was private [emphasis added] money and should not be transferred to a Government appointed body.[383]
- *The Age* reported that 'Federal Law Enforcement Agencies' were working on allegations of money-laundering by Australian solicitors. Reference was made to the confidentiality provisions presently attached to the reporting of cash transactions over $10,000 by solicitors to their banks, implying that criminal identities were accordingly kept secret.
- The Attorney-General dropped any pretence of sympathy or respect for the LIV position in a speech replete with memorable exaggerations:[384]
  - ❑ The LIV was 'simply a trade union desperate to protect a cosy closed-shop arrangement.'
  - ❑ 'The real problem for the Institute is that the Practice Board spells the end of the Institute's monopoly position with the proposal to end compulsory membership of the Institute.'
  - ❑ Mrs Wade said the Institute also wanted to keep control of the [SGF] and knew the Legal Practice Board would be the logical place for the fund. In her view, the Institute's 'independence furphy' was the result of its appointing a public relations consultant

[379] Ibid and Robert Cornall, 'Considerable Sums of Money: A Short History of the Solicitors' Guarantee Fund' (1995) 69 *Law Institute Journal* 14.

[380] Paul Conroy, 'Solicitor "Guilty" over $1.9m', *The Age* (Melbourne), 21 March 1995, 4.

[381] Paul Conroy, 'Maverick Lawyers in Wade's Sights', *The Age* (Melbourne), 21 March 1995, 4.

[382] Paul Conroy and David Wilson, 'Lawyers lobby Against Reforms', *The Age* (Melbourne), 27 March 1995, 3.

[383] Ibid.

[384] Ibid. *The Age* stated that from July 1990 to June 1992, $58.7m was processed through 2625 transactions (in excess of $10,000 each) through solicitors' trust accounts. Of this, '308 suspected transaction reports [where tellers believed criminal activity could be involved] involving $7.428m were made about Melbourne solicitors'.

on a $20,000 a month contract. Mrs Wade said she was not criticising the payment, although she wondered how it was funded (emphasis added).

- ❑ 'Personally, I think anyone trying to present solicitors as a brow-beaten and downtrodden class of public heroes is entitled to all the money they can get', and described the 'independence' strategy as arising from the recognition that concern about losing the monopoly was 'about as appealing as broccoli icecream'.[385]

- LIV President, Rod Smith immediately reacted to the Attorney's description of the profession as a 'closed shop' as an 'unjustified nonsense'. He argued that the Legal Practice Board would be appointed by the Executive and as such would be a threat not only to professional independence but to democracy.[386] *The Age* Editorial pronounced self-regulation as not workable, with the LIV being 'reluctant to take a firm stand on members whose professional standards leave much to be desired'.[387]
- The *Law Institute News* (hereafter referred to as LI News) asserted that the SGF:

  > has been statutorily prevented from building up reserves in high income years to meet shortfalls in years of low income or big claims. There is no law of economics which ensures that the income of a compensation or insurance fund will always exceed claims but that is the accounting basis on which the SGF operates. That fatal flaw in legislation has now become apparent.[388]

- Springvale, North Melbourne, Fitzroy and Melbourne University Legal Services called for the proposed Board to be chaired by a current or retired Judge, made up of lawyers elected by the profession and lay persons appointed by the Attorney, in order to resolve the deadlock.[389]
- The earlier proposal by the LIV-SGF Management Committee to cap SGF payments on each defaulting solicitor to $2m (as provided for under s70 of the *Legal Profession Practice Act* 1958 (Vic) — but previously unutilised) was put on the LIV Council agenda for June 1995, and then deferred pending 'talks' with Treasury officials.[390]

[385] Shane Green,' Minister Attacks Cozy Lawyers', *The Age* (Melbourne), 5 April 1995, 1 and 6.
[386] Rod Smith, Letter to the Editor, 'Threat to Lawyers' Independence Looms' *The Age* (Melbourne), 6 April 1995, 16.
[387] Editorial, 'Wading Into the Law', *The Age*, (Melbourne) 6 April 1995, 17.
[388] *Law Institute News*, April 1995, No 4.
[389] Michelle Coffey, 'Alliance Rejects Law Board Plan', *The Australian* (Sydney), 6 April 1995, 8.
[390] David Wilson, 'Clients to Lose $25m in Law Cap', *The Age* (Melbourne), 26 June 1995, 1.

- *The Age*[391] listed the SGF 'big debtors' as:

R.J. Martin	Kew	$12–17m
R.D. Silverstein	Kew	$11.6m
B.H. & N.G. Tregent	City	$11.6m
G.J. Ogge	Glen Iris	$ 9.0m
S. Christodolou	Kew	$4.6m
R.P. Makarucha	Eaglemont	$1.4m
	TOTAL	$50.2 – $55m

The next day, *The Age* Editorial again focussed upon the LIV, predicting an SGF deficit for the year ended 30th June 1995 in excess of $20m, repeating that another 33 practitioners were under investigation and criticising the $2m 'cap' on the basis of its retrospective operation.[392]

- On 27 June, the Premier, Mr Kennett, claimed that the LIV had kept the Government in the dark and had been 'almost negligent' in its SGF management; the LIV responding that the Government had been on notice about the problems for over nine months and was obliged to s upport the fund because of its contributions to legal aid over the years.[393]
- On 29 June, the LIV deferred consideration of the 'cap' proposal pending more talks, argued against any increase in solicitor contributions because there was no precedent for that and reiterated (because of past contributions to legal aid) the SGF claim on the Government. The next day, the Premier predicted that the Government would not come to the rescue and suggested that the future SGF should decline coverage for investment transactions.[394] The suggestion was taken seriously inside the LIV, which well understood, whatever the decision about financing of past thefts, that the LIV could simply not afford the damage to the professional standing of lawyers from continuing losses. In early July, 200 mortgage practitioners were addressed by LIV Treasurer Geoff Provis and told that the LIV 'may not continue to regulate mortgage practices in the way it has (if at all)'. Those attending were put on notice that SGF cover was not assured in future, and the July LIV Council meeting established a Solicitors Mortgage Group, with the aim of preparing for a possible deregulated operating environment.[395]
- The Attorney-General indicated to an Attorneys-General meeting in Perth on 14 July 1995 that the Government was likely to levy practitioners up to $500 per head per annum to make up the SGF shortfall.[396]

[391] Ibid.
[392] Editorial, 'Lawyers and Money', *The Age*, (Melbourne), 27 June 1995, 15.
[393] Clare Kermond, 'Kennett Attacks Law Fund Handling', *The Age* (Melbourne), 27 June 1995, 3.
[394] Clare Kermond, 'Many May Lose Legal Fund Cash: Kennett', *The Age* (Melbourne), 30 June 1995, 4.
[395] *Law Institute News*, August 1995, No. 8.
[396] Nicole Brady and Paul Conroy, 'Big Changes Coming for Lawyers and Courts', *The Age* (Melbourne), 15 July 1995, 3.

- A partner of LIV President Mark Woods in the (rural) Traralgon firm of Tyler, Tipping and Woods was found to have misappropriated nearly $400,000 to support a failed ostrich farming venture. Although Mr Woods was completely blameless, he eventually accepted that he had no choice but to publicly stand down as President while the LIV established his bona fides in an investigation.[397] The coincidence with the continuing SGF plight was agonising for the LIV and the stand down, said to have been strongly resisted by Mr Woods, symbolic of LIV fortunes generally.
- The LIV announced that the $2m cap was no longer 'its preferred option', and *The Age* described the $10 per annum contribution by each practitioner to the SGF as 'pathetically inadequate'.[398] Three days later (27 July 1995) *The Age* published a trio of letters in which most of the then current arguments were recited:
  - The Attorney maintained that the LIV had not previously complained of the need to accumulate reserves.'It [the LIV] has a vested interest in allowing the funds of SGF to be applied for these public purposes and, until recently, has encouraged this for obvious reasons'.[399] The benefits of 'referral back' to lawyers from legal aid, and of training to new lawyers via Leo Cussen Institute, were restated.
  - In contrast, LIV Council member Michael Gawler produced the normal LIV response that the legislation did not permit reserve accumulation,[400] an assertion which (while formally quite correct) denied the reality of LIV political control of the Act and the SGF until the accession of Mrs Wade.[401]
  - Finally, BM King, an LIV member of East Malvern revived the 1930's debate by describing the Government proposals as 'grossly unfair [in that they applied] group responsibility for individual crimes'. Equating the concept to teachers compensating for child abuse, nurses for assaults upon patients, journalists for plagiarism or politicians for political corruption[402] this correspondent did not, however, allude to the fiduciary duty arising from the relationship

[397] David Wilson, 'Law Body Chief Stands Down Over Trust Probe', *The Age*, (Melbourne) 15 July 1995, 1.
[398] Editorial, 'A Legal Nicety', *The Age* (Melbourne), 24 July 1995, 15.
[399] Jan Wade, Letter to the Editor, *The Age*, (Melbourne) 27 July 1995, 12.
[400] Ibid.
[401] In April 1986 the LIV asserted that there was 'no need for government backing for the Solicitors Guarantee Fund. While the Law Institute acknowledges that there is always a possibility that massive defalcation(s) could exhaust the Fund reserves (emphasis added), the fact is that even the recent matter of Cox involving so far $7m will not significantly inconvenience the beneficiaries'. See memo from Messrs Lewis and Carmody (LIV) to 'Working Group on Future Funding', 30 April 1986, provided by the LIV to the author; this and other comments were made by the LIV to an informal group of the statutory beneficiaries and the Law Department at the time of internal argument in relation to funding certainty for the beneficiaries, above 'Competing Interests'.
[402] *The Age* (Melbourne), above n 399.

between lawyers and clients, or to the financial advantages available to the profession collectively in consequence of its ability to hold trust funds.

The LIV suggested staggering of claims payments over three to four years, which it calculated would be possible because interest rates were once again beginning to rise and SGF income could be expected to increase.[403]

REPORT OF THE ATTORNEY-GENERAL'S WORKING PARTY ON THE LEGAL PROFESSION

The long awaited report of the Attorney-General's Working Party was delivered by Crown Counsel Greg Craven to the Attorney-General on 21 August 1995. Entitled 'Reforming the Legal Profession', it represented a major policy contribution to the Government by the Working Party under Mr Craven.

The Report dealt with many complex issues affecting problems other than the SGF, but its contribution to the subsequent legislation on this issue was nevertheless deliberate and authoritative. It noted that all defalcations were committed by 'small law firms', most of which were single practitioners, and that 78 percent of defalcations arose from investment arrangements.[404] The Report eschewed 'caps' on compensation as destructive of public confidence and recommended that solicitors should make a substantial contribution to the SGF 'as a matter of principle'.[405]

Several methods for calculating contributions were canvassed before the Report recommended that a Legal Practice Board set these amounts up to a ceiling specified in the Act.[406] Recommendations that the SGF be administered by a public body[407] and that that body be the proposed Board[408] were expected; less predictable, given the Government's erstwhile lack of confidence in the LIV's ability to manage the contingency question, was the view that the LIV as a Recognised Professional Association (hereafter referred to as RPA)[409] should, in respect of any lodged claim, investigate, recommend disposition and, if necessary, an appropriate claims contingency.[410]

[403] Paul Conroy, 'Law Body offers Instalment Deal for Outstanding Debts', *The Age* (Melbourne), 3 August 1995, 8.

[404] Victoria, Department of Justice, Attorney-General's Working Party on the Legal Profession, 'Reforming the Legal Profession', August 1995, para 2.2.2, p 40.

[405] above n 404 Ibid para 2.3.8, p 42.

[406] Ibid para 2.3.12, p 43.

[407] Ibid para 2.3.2, p 40.

[408] Ibid para 2.3.3, p 41.

[409] 'Recognised Professional Association', or RPA, is the generic term used by the *Legal Practice Act* 1996 (Vic) (hereafter referred to as LPA 1996 (Vic)) to describe organisations such as the LIV that seek to represent (and regulate) groups of practitioners, under the general regulation of the Legal Practice Board. See LPA 1996 (Vic) ss 103 and 110.

[410] 'Reforming the Legal Profession', above n 405, para 2.3.3, p 41.

The Government announced on 24 August 1995 — three days after the report was delivered to the Attorney — that the fund deficit would be met by a levy of up to $500 per head per annum. There would be no Government rescue package. However, the Attorney apparently accepted the suggestion that three of the seven members of the new Legal Practice Board should be elected by the profession, and for the time being, this decision effectively blunted further professional criticism of the reform package.[411]

The report noted that the provisions of *Legal Profession Practice Act* 1958 (Vic) s 53(11) prevented the establishment of reserves over $4m, after providing for all ascertained and contingent liabilities, and stated:

> There is some doubt as to whether the phrase 'contingent liabilities' ... (including any liability for claims whether actually made or not) includes incurred but not reported liabilities. It has been argued that the consequence of this provision has been to prevent the SGF from building up substantial reserves as prudent insurance practice would require.[412]

This oblique discussion reflected the somewhat fine distinction between claims, other than rejected claims, which had not been reported, although they were 'known about' through the LIV's inspection of a defaulting solicitor's books — which the LIV agreed it should allow for when setting its contingencies — and unreported but possible claims, however remote, which the Attorney considered should be allowed at their full value.[413]

The actual (if somewhat obscured) focus of the Craven Report was upon reserves, i.e. the extent to which funds could be accumulated *above and beyond contingencies*, however calculated, although it seems possible that the Attorney did not then fully understand the distinction. Clearly, the $4m limitation on the reserve account was hopelessly inadequate, and merited removal. This in fact was the recommendation[414] although the actual wording reflects an (uncharacteristic) confusion as to the difference for accounting purposes between a 'contingency' and a 'reserve', and the fact that 'prudent insurance' practice in this context only affects the former.[415]

Acknowledging the debate about LIV expenditure from the ISA (above pp 117–21), the Report attempted a conciliatory gesture in its recommendation that a 'limited amount' of money be allocated to RPA's for 'certain training and educational purposes', as determined by the Board,[416] and suggested the extension of SGF indemnity to cover thefts by non-legally qualified employees of firms.[417]

[411] Paul Conroy, 'Lawyers Face $500 fee to Save Fund', *The Age* (Melbourne), 25 August 1995, 3.

[412] 'Reforming the Legal Profession', above n 404, para 2.3.16, p 44.

[413] above n 399. Evans, above n 7, Appendix J p 433–443 explores this distinction fully and argues that the Attorney's view was incorrect.

[414] 'Reforming the Legal Profession', above n 404, para 2.3.18, p 45.

[415] Specifically, the Recommendation suggested that the Act 'be amended to require ... contingency and solvency reserves to be built up consistently with prudent insurance and accounting standards' (Ibid). See also Evans, above n 7, Appendix J pp 433–443 re discussion on effect of AAS26 on the debate, with specific reference to relevant sub-clauses.

[416] 'Reforming the Legal Profession', above n 404, para 2.3.20, p 45.

[417] Ibid para. 2.3.22, p 46.

In an effort to encourage partner scrutiny of their peers' conduct, it was also recommended that coverage of innocent partners be retained, provided that their conduct was not only honest and reasonable (the old test) but also was not negligent.[418]

Finally, the reduction of future claims was briefly addressed. Reciting the LIV estimate of $1.85 billion lodged in investment and mortgage funds held by solicitors at 30 June 1995, the Report implicitly recognised the potential for continuing catastrophe unless SGF exposure was reduced. It nevertheless thought itself unable to comment on measures to achieve more stability in the fund and noted that a specialised interdepartmental working group was addressing the issues.[419]

Again, there was silence on the issue of transfer of trust account interest to the SGF. It was then finally clear that the Government would not alter its views and considered that the payment of interest on clients' trust balances to the SGF was not a breach of any fiduciary or other duty because it was authorised by the *Legal Profession Practice Act* 1958 (Vic).[420]

NO LONGER A LITTLE LEVY

On 25 October, 1995 the Attorney announced that the levy imposed on solicitors to bail out the SGF would be up to $1,500 per annum.[421] The same day the LIV released the SGF Annual Report for 1994/95 in which, on a conservative reading, a net deficiency of $32.2m for the year was disclosed.[422]

The Attorney-General equated the $10 per annum charge, effectively fixed in 1946, as equivalent to $400 per annum just on the basis of inflation, but said that a sliding scale would be introduced in Victoria to allow for differing risks.[423] LIV President Mark Woods, describing LIV members as 'absolutely furious', said the increased levy was unnecessary if the Government had accepted the LIV rescue plan (above p 142). Mr Woods energetically described the Government announcement as

> a solution that will cost everyone except the Government itself. This is outrageous considering that Government has been the main beneficiary of the Fund, receiving nearly $190m over the past 13 years.[424]

In reviewing the issue, LIJ staff journalist Richard Evans asked why, since the Attorney had suggested that firms organising contributory mortgages were to pay a higher levy, coverage of such mortgages was to be excluded?[425] The

[418] Ibid para. 2.3.26, p 47. A restriction which has proved controversial in the subsequent Max Green defalcation. See *LPA* 1996 (Vic), s 218, which expresses the indemnity to apply providing the partner acts with 'due diligence'.
[419] Ibid 44, para 2.3.14–15.
[420] Letter from Chris Humphreys, Director of Policy and Executive Services, Department of Justice, to the author, 6 October 1995.
[421] *Law Institute News*, November 1995, No 11, p 1.
[422] SGF Annual Report, 1994–95, Law Institute of Victoria.
[423] *Law Institute News*, above n 421.
[424] Ibid.
[425] Ibid.

Government response to this entirely logical point has not been made clear, but it may be a somewhat muddled attempt to make that sector of the profession pay for its 'prior sins'.

For its part, the SGF Annual Report (1994–95) came out punching, accusing the Government of directing[426] that $2.7m be distributed to beneficiaries, including $1.6m which was the exercise of pure discretion.[427] The attack was not, however, sustainable in light of the record $32m deficiency after provision for $51.3m in outstanding claims.[428] Those claims, which were higher in total than those disclosed by *The Age* in June 1995 (above p 144), were listed as follows:

Savas Christodolou	$ 3,942,187
Dudley Tregent & Co.	$ 1,651,641
Richard Makarucha	$ 1,323,884
Romuald Martin	$19,149,916
Geoffrey Ogge	$ 8,544,645
Ronald Silverstein	$ 4,514,685
Stanley Rosenberg	$24,697,852
Total	$63,824,810

These claims were, of course, stated at their face value, and were unlikely to be paid out at that level. Nevertheless the figure, however calculated, was the worst in the 47 year history of the SGF.[429]

The matter of calculation took up more space in the SGF Annual Report (see previous page) than usual. It had identified publicly the disagreement between the LIV and the Government on the issue of contingent liabilities. The Attorney was convinced that the SGF had not made adequate provision for future claims, and considered this issue to be one justification for her (effective) takeover of the fund. For once, the Opposition agreed. Barry Pullen, Labor MLA for Melbourne, considered that the profession needed to accept some 'collective responsibility. The profession must put increased pressure on those of its members who are not sufficiently scrupulous in handling trust funds'.[430]

Peter Batchelor, Labor MLA for Thomastown, who referred to theft from two of his elderly constituents by solicitor Mrs Chriso Kyriacou, went a lot further, and appeared to refer to a culture of complicity in the profession that had persuaded him, at least, that big changes were needed:

[426] *Law Institute News*, 29 September 1995.

[427] $1.6m to LACV pursuant to s 53(9) of the *Legal Profession Practice Act* 1958 (Vic), and $0.53m to each of the Victoria Law Foundation (s 53(7)) and Leo Cussen Institute (s 53(7A)] at a time when claimants were suffering. [SGF Annual Report —1994–95, above n 422, President's Report, 1.

[428] Ibid 2.

[429] Paul Conroy, 'Solicitors Fund Claims Hit $65m', The Age (Melbourne), 25 November 1995, 6, which reported outstanding claims at $65m.

[430] *Law Institute News*, December 1995, 'SGF Levy Passed', 1.

> the circle of rottenness does not end [with Mrs Kyriacou]. I should not create that impression because there is a second ring around [his constituents]. While people experienced in the law are able to protect themselves and appear to distance themselves from the core of corruption, they are as guilty as the others. They are there on the periphery.[431]

This cultural allusion was reported verbatim in the LI News for December 1995, without further comment. The LIV, in the SGF Annual Report, bolstered its position by arguing that:

- its provision for claims (in the SGF Balance Sheet 1994/95) at $51.3m was accurate, in contrast with the actuarial assessment of Trowbridge Consulting (commissioned by the LIV for the purpose of costing its own rescue plan[432]), but in the process projecting claims at $65.3m.
- the Trowbridge estimate was of academic interest only, useful to determine the 'state of the Fund on a fully costed basis (rather than the basis provided by the Act),[433] and to help with future remedial strategy.[434]
- the SGF is compensatory in nature (rather than identical to insurance)
- the basis of the Trowbridge actuarial provisions for contingent claims was inappropriate.

Unfortunately, the Auditor-General in his audit report on the fund[435] which is annexed to the SGF Annual Report, stated that he preferred the actuarial estimate of contingent claims to that of the LIV, and accordingly considered that both the operating deficit in the Fidelity Account ($32m) and the claims provisions ($51m) were 'understated by $14m'.[436]

The only positive trend in an Annual Report which otherwise seemed to confirm everything the Attorney said about the SGF and its administration was an increase in fund income for the year by $5.1m to $18.3m. This directly reflected[437] the recent increased bargaining power of the LIV to extract market interest rates from banks in respect of the 'Westpac monies' (above p 132) and a slight increase in general market rates. The LIV properly decided to tabulate the decline in the SGF performance over the years 1991–5 in Appendix 4 to the Report.[438]

THE NEW LEVY, A NEW FUND

With Opposition support, the Government decision to impose a levy on practitioners and remove contributory mortgage indemnity from the fund was passed on 5 December 1995.[439] In the same month, the Government's 'Draft

[431] Ibid.
[432] Evans, above n 7, Appendix J pp 437–441.
[433] SGF Annual Report — 1994–95, above n 422, 7.
[434] Ibid.
[435] SGF Annual Report — 1994–95, Auditor-General's Report, 31 October 1995.
[436] Ibid.
[437] SGF Annual Report, 1994–95, Secretary's Report, 1.
[438] Evans, above n 7, Appendix G, Section 4, 'Summary of Key Account Results over the Years 1991–2 to 1994–5', 352.
[439] *Legal Profession Practice (Amendment) Act* 1995 (Vic).

Proposals' for general reform of the legal profession were released and selected respondents were invited to comment by 31 January 1996. The Attorney-General did not wait to increase the levy or limit SGF indemnity under the general reform proposals (replacing the SGF with a new 'Legal Practitioners Fidelity Fund' as from the 1 January 1997[440]), as she considered that the levy was necessary as from 1 April 1996. The 'Draft Proposals' contemplated a new regulatory regime only from the later date of 1 July 1996, subsequently extended to 1 January 1997, which would make administration of the new levy scheme complex and lead to delays in higher levels of income to the fund.[441]

Section 8 of the *Legal Profession Practice (Amendment) Act* 1995 (Vic) permitted a levy up to $1500 per annum, the exact amount for each practitioner to be determined by the Attorney-General according to the 'class' of solicitor.[442] The levies, which varied between $75 per annum for an interstate practitioner and $1500 per annum for a sole practitioner with responsibility for contributory mortgages, placed higher costs on those with trust funds and a contributory mortgage practice ($250 – $1,500) than on those who simply controlled trust funds ($250– $750).[443]

While the removal of contributory mortgage indemnity from the SGF was to commence only in April 1996, the higher levy was payable from 1 January 1996. Institute President Mark Woods wrote to members on 4 March 1996[444] complaining that no other trade or profession had to finance its own regulation or fidelity compensation, but without reference to overseas examples[445] or to the special position of the legal profession as a custodian of clients' funds. Mr Woods justified the appropriation of interest on trust balances on the basis that it was primarily for the benefit of the community rather than the profession.

The Age reported in early April that many solicitors had been automatically suspended from practice for delay in paying the levy,[446] and Mr

[440] *Legal Practice Act* 1996 (Vic) s 388. See Appendix C for a schematic representation of the relationship between the Fidelity Fund and other key innovations of the new structure.

[441] The 'draft proposals' were commonly understood to be close to the final form of the Act. Coming after the Attorney's 'Agenda for Change' of June 1994, and her Working Party Report of August 1995, they were clearly drafted by Parliamentary Counsel. A new Part 6 of what was to become the *Legal Practice Act* 1996 (Vic) referred to 'Clients' Money'. This part integrated the 1995 *Amendment Act* into the new structure and proposed significant rearrangement of the various beneficial accounts within the SGF.

[442] The criteria to be used in determining which class applies to each practitioner included: the number and type of practising certificates held by different groups of practitioners, ratios of sole practitioners to partnerships, numbers of practitioners holding trust monies and / or receiving monies to be lent on contributory mortgages, status as a non-resident practitioner, and the relationship between 'employee practitioner' status and firms holding trust monies. See *Legal Profession Practice (Amendment) Act* 1995 (Vic), s 8(a)–(h).

[443] The Attorney released her determination of 'classes' and levies on 22 December 1995. They were published in the *Law Institute Journal* in February 1996 along with a 'ready reckoner' prepared by LIV staff. See J Syme, 'Understanding the Levy' (1996) 70 *Law Institute Journal* 8–11.

[444] Mark Woods, LIV President, Letter to Members, 4 March 1996.

[445] See Evans, above n 7, Ch 3.

[446] Paul Conroy, 'Legal System Uncertainty as Solicitors Reject Levy', *The Age* (Melbourne), 2 April 1996, 1 and 2.

Woods argued that the levy was far higher than other States.[447] The Attorney responded that '[the levy] is no greater on average than the levy in NSW'.[448]

To date, there have been no significant reports of solicitor evasion of the levy in Victoria. Practitioners complied with all changes. In May 1996 the LIV Executive Director Ian Dunn made a new concession when he affirmed that modest contributions to fidelity compensation (such as in NSW) represented a form of fidelity insurance for solicitors *in partnership*, but otherwise maintained his general view that the use of interest on trust balances for fidelity compensation remained appropriate.[449] The LIV has not since altered its position on the use of this money.

POSTSCRIPT

The SGF commenced operations in 1949 as a conventional compensation mechanism for solicitor theft. It continued satisfactorily and without very much attention in that role until a large theft provoked a search by practitioners for income that was thought to be unavailable and that solicitors had never before sought to apply to this purpose.

Things started to become difficult almost as soon as the LIV started to use that additional income source. A very few lawyers assessed that it might not be the way to go, but could not adequately articulate the moral risk of that path. The conflicts of interest, which later became evident,[450] were then hidden. The unpopular perception of the few who were uncomfortable (that the interest on trust accounts ought somehow to remain 'unavailable') could not then be described as anything stronger than disquiet about the ethics of the appropriation. In the age before computing, that was not enough and it was not a credible objection.

The instincts of lawyers such as Ralph Burt may have warned them that trouble was ahead, but that also was not enough to overcome the clear fact that banks rather than clients were then the only beneficiaries of the interest. Perhaps then (as now) a concern for 'ethics' was seen as merely a focus on 'rules'. It also seems likely that issues of propriety going beyond an individual and towards an institutional obligation,[451] which may have enabled a revitalised profession to address the issue, did not appeal. Appendix B sets out how an 'institutional ethic' might be conceived. The LIV, had it chosen over the last three decades to compare its approach to those of foreign law societies, would have reflected upon the fact that nearly all overseas jurisdictions[452] eschewed the use of clients' money in fidelity compensation and the costs of self-regulation.

[447] Mark Woods, Victorian Lawyers Being Penalised', Letter to the Editor, *The Age* (Melbourne), 5 April 1996, 12.
[448] Jan Wade, 'Legal Levy is Fair', Letter to the Editor, *The Age* (Melbourne), 11 April 1996, 14.
[449] *Law Institute News*, May 1996, No 5, p 2.
[450] Evans, above n 7, Chs 4–6.
[451] Evans, above n 7, Ch 7.
[452] Evans, above n 7, Ch 3.

Despite an attempt to draw the Attorney's attention to the difference between legality and ethics and specifically to the issues raised by the use of interest on clients' trust balances,[453] the Government has not been willing to debate the issue. The structure of the *LP Act* 1996 (Vic) confirms the *status quo* on the issue (see Appendix C below). This is unlikely to change while government believes it can support a range of government and regulatory purposes via undemanding clients. At present, both government and profession have a regrettable interest in silence on the nature of this fiduciary responsibility in the digital age.

Nevertheless, it is the legal profession rather than government that espouses an ethical concern for clients and has always had a very personal interest in their future welfare. The American Bar Association (ABA) acknowledges that compensation for defalcation is critical for professional integrity.[454] Significantly, the ABA also acknowledges that if it is possible to pay interest to clients on their trust balances, then this should occur.[455] This lead has since been affirmed by the United States Supreme Court in a decision that has confirmed that 'interest follows principal'.[456]

Although much public interest law reform and research activity is supported by the 'taxation' of interest on clients' balances — particularly in Australia[457] — it is difficult to see how the 'categorical imperative' of the fiduciary duty to clients, now enabled by developments in digital computing, can be ignored on public interest grounds. The legislative appropriation of the interest is demonstrably legal but that is not the point. What was acceptable for practitioners is no longer. It seems clear that it is ethically necessary for members of the profession[458] to advise their clients that there is a straightforward process to increase their income (or to offset their legal fees), by earning interest on their normal trust balances. The innovators among solicitors are likely to show the way here as firms compete to increase their attraction to clients. As that happens, the underlying aims of the old SGF and the new Fidelity Fund — to compensate fully for client losses — will return to harmony.

[453] Letter by the author to the Attorney-General, 17 October 1995, in response to a letter from her Director of Policy and Executive Services, Chris Humphreys, of 6 October 1995, in which the Government avoided the ethical issue by relying on the dominance of statute.

[454] Interview with John Holtaway, Client Protection Counsel, American Bar Association, Chicago, 12 May 1998.

[455] Interview with Ken Elkins, Staff Counsel, Interest On Lawyers Trust Accounts (IOLTA), American Bar Association, Chicago, 12 May 1998.

[456] *Phillips v Washington Legal Foundation* (1998) 94 F. 3d 996 .

[457] Evans, above n 7, Ch 3 and Appendices G and K.

[458] Allan Cornell, LIV President in 1982–83 at the time of the 'Westpac' breakthrough and a chief architect of the process (above p 36) subsequently condidered that the interest earned on trust accounts should be paid to clients. Interview with Allan Cornell, Partner, Blakes Solicitors, Melbourne, 8 June 1995.

Appendix A

TIMELINE OF THE SOLICITORS GUARANTEE FUND (VIC)

1946	*The Legal Profession Practice Act* 1946 (Vic) establishes the Solicitors Guarantee Fund.
1947	
1948	The *LPP Act* 1946 (Vic), and the SGF, commence on the Ist January 1948.
1957	The 'cap' on payments from the SGF increases from £ 5,000 to £ 10,000 per claim.
1961	SGF cap increases to £ 20,000.
1962	
1963	A L Row steals over £ 100,000 from his clients.
1964	LIV announces that the SGF has only £ 80,000 in its accounts.
1965	Clients' interest is diverted to the SGF, i.e., the interest on a statutory deposit of 33% of
1966	each trust account. The cap on payments from the SGF is raised to £ 500,000.
1967	The VLF is established and becomes entitled to 80% of excess SGF funds. Legal aid
1968	is to receive 20% of the excess.
1969	Distribution of the SGF excess is varied : 70% goes to the VLF and 30% to legal aid.
1970	
1971	
1972	40% of lowest trust balances are to be deposited with the LIV. SGF excess funds
1973	are divided equally between the VLF and legal aid.
1974	
1975	Betty Bryant of RW Barrie and Co. steals $7m of clients' funds. The Dawson Committee
1976	is set up to investigate the financial implications for the SGF and recommends a major
1977	restructure.
1978	
1979	The unitary SGF is subdivided into an Income Suspense Account (to collect clients'
1980	interest and distribute it to the LIV for regulatory expenses, 5–10% to the VLF and 10—
1981	15% to LACV) and a Fidelity Account (for defalcation claims with the balance to LACV).
1982	Deposit of lowest monthly balance percentage is raised from 60% (1979) to 66.66%.
1983	Westpac and other banks agree to pay interest to the LIV on residual trust balances, on
1984	an ex gratia basis.
1985	Cox defalcation.
1986	Skinner defalcation.
1987	The VLF share of the Income Suspense Account is reduced from 5–10% to 0–10%. The
1988	Stock Market crash of October 1987 signals the decline in interest rates which
1989	contributes to eventual SGF insolvency.
1990	Rosenberg defalcation produces a defalcation provision of $24.7m in the SGF accounts.
1991	John Little imprisoned, highlighting LIV use of SGF funds for quasi-professional pur-
	poses.
1992	Attorney-General's Working Party recommends minor changes to improve SGF
	income.
1993	Payment of ex gratia interest on residual balances becomes compulsory for all banks.
1994	LIV-SGF expenditure is ratified but capped at the 1993 level. The SGF has a $9m
	deficit.
1995	SGF deficit rises to $32.2m. The A-G foreshadows a fidelity levy up to $1500 per head.
1996	*The Legal Practice Act 1996* (Vic) replaces the SGF with the Legal Practitioners
	Fidelity
	Fund. This new fund and the LP Act structure retain access to clients' interest.

Appendix B

THE BASIS OF AN 'INSTITUTIONAL ETHIC' IN THE CONTEXT OF THE ADMINISTRATION OF THE SOLICITORS GUARANTEE FUND (VIC)

An 'institutional ethic', if it can be asserted on any basis, has its roots in Thomas Aquinas'[459] concepts of moral philosophy. A central dichotomy in moral philosophy that is relevant to the SGF is the distinction between teleological and deontological approaches to moral decision making. Teleological argument asserts that final outcomes are critical in making moral choices. Put in slightly more contemporary terms, teleology is the view that 'outcomes' equals 'the greatest good for the greatest number', and is otherwise known as utilitarianism.[460]

In contrast, deontology may be defined as the 'duty of *moral obligation*',[461] where moral action is taken with regard to first principle conceptions of what is 'right' rather than what the outcome or consequences may be.[462] Neither system is entirely satisfying. The teleological 'end justifies the means' philosophy has been used to legitimise atrocities and abuses of human rights in this century and may have fewer adherents amongst lawyers and jurists in particular than in the general population. It is nevertheless the philosophy that underlies the decision of the Attorney-General and the LIV to continue interest appropriation, on the basis that the greatest good to the greatest number may continue to be done through the use of the interest for legal aid and other worthy purposes. Similarly, deontological 'moral justification' without regard to consequences is said by many to lead to social evil, though the common examples (euthanasia, abortion) may be considered to have bad or undesirable consequences whichever way a decision is made. Despite the lack of precision, the deontological concept of moral justification seems to find itself at the base of legal ethics more often than the teleological alternative.

Moral justification owes much to Emmanuel Kant (1724–1804) a Prussian philosopher who was concerned to offer a secular alternative to Aquinas' synthesis of faith and reason as the basis of moral decision making. It is suggested that the path towards an institutional ethic which would encourage the payment of interest, is marked out by Kant's contribution.[463] Greenwood describes that contribution as follows:

> Kant identified two fundamental values: freedom and reason. He regarded these two values as being distinguishing characteristics of both humanity and divinity. Freedom and reason define ethical action in that we are free to do anything that anyone else is free to do without contradicting our common human purpose. This is what Kant called the 'categorical imperative.

[459] Thomas Aquinas, *Sumna Theologica* (1265–1273) (trans. by Thomas Gilby, 1969).
[460] S Ross, *Ethics in Law: Lawyers' Responsibility and Accountability in Australia* (1995) 21.
[461] T Greenwood, 'Professional Integrity and Corporate Governance'. Address to Australian Corporate Lawyers Association (Vic), 16 April 1996, 11.
[462] Ibid.
[463] I Kant, *Metaphysics of Ethics* (1797).

> Freedom and rationality make for professional integrity because with these two things we become autonomous, . . . in the sense that our integrity is based on . . . the right of each person to be an end, and not a means to someone else's end. The Kantian ethic is based on our duty to respect these fundamental principles rather than focussing on consequences. As Kant would put it "Let justice be done though the world may perish . . .".[464]

It is also the path which would allow the profession to underpin the development of an institutional ethic:

> Kant's model of freedom and reason is particularly useful to us as lawyers because it gives us confidence both that we can rationally measure individual laws against natural law as the ultimate norm which attributes intrinsic value, and also use natural law freely and rationally as a foundation upon which we can discern and rank value...into a system that may be respectably called professional integrity.[465]

This is undeniable, but if contemporary notions of 'quality' and 'best practice' have anything to contribute to our understanding of outcomes it is that a longer view does reward lawyers financially because good *process* usually meets clients' individual and group needs more than does the focus on short term results.

Abel has called for ethics that determine '. . . not how . . . things should be done but whether they should be done at all.'[466] In 1986, the American Bar Association Commission on Professionalism urged lawyers to adopt higher standards than those required by disciplinary rules, and named a devotion to public service as the dominant feature of professionalism.[467] If that remains true (despite the contrary trend to the 'expert/technician' lawyer) the development of an institutional duty of loyalty gives legitimacy to a public service which does not give to the community with one hand (fidelity compensation) but take away with the other (through their interest on trust balances).

It is clear that, because ethical codes tend to atrophy if they evolve into specific prohibitions, an institutional duty of loyalty to clients ought to be expressed positively as a duty of the LIV. In the context of *public sector* ethics, an environment with much in common to the LIV in the present climate, Charles Sampford makes it clear that ethics '...is seen as what government should seek to achieve rather than what it should avoid'.[468]

The new LIV is no longer a pure self-regulator and can no longer compel membership. It has every reason to seek a positive ethical framework to attract membership for the right reasons, ie, to encourage a renewal of the profession in the public interest, and incidentally as the best way of assisting the continuing collective relevance of lawyers.

It is suggested that Cowdery Q.C.'s observation that the community identifies the lack of functionality in legal institutions as synonymous with the same

[464] Greenwood, above n 461, 4.
[465] Ibid 5.
[466] R Abel, 'Taking Professionalism Seriously', *Annual Survey of American Law*, 1989, 56.
[467] Ross, above n 460, 47, referring to the ABA Commission on Professionalism, 'In the Spirit of Public Service: A Blueprint for the Rekindling of Lawyer Professionalism', 1986, 10 & 50.
[468] C Sampford, 'Institutionalising Public Sector Ethics' in N Preston (ed.), *Ethics for the Public Sector — Education and Training*, (1994) 25–26.

trait in lawyers[469] merely affirms a public expectation that lawyers ought to behave ethically whether acting individually or collectively. Arguably the willingness of lawyers as individuals to allow their clients' funds to be appropriated, and as a profession to provide the means for that appropriation, are functionally indistinguishable. Although no Australia-wide survey has been conducted to find out what the community really thinks about its lawyers,[470] Parker identified legal ethics as the focal point of community frustration with both individual lawyers *and* legal institutions in his influential Discussion Paper for the Senate 'Cost of Justice' inquiry.[471] Parker reaffirmed that 'ethics' essentially refers to the ethos or shared culture which *ought* to control the wider functioning of lawyers (para 1.9), a far wider role than one of regulation (para 2.13) and a role that appeals to conscience rather than sanction (para 2.20).[472]

The LIV, as a legal institutional archetype with continuing responsibilities to the public, may be considered to owe a duty collectively and through its officers to the community at large and to clients as individuals, to act corporately in the interests of justice in each function it performs. This institutional ethic goes beyond individual responsibilities because, as Sampford says

> ... we are a society of institutions not individuals and the greatest problems our society faces are problems of institutions. Thus, in a world dominated by large institutions, ethics is not merely or even primarily, an individual concern.[473]

Should the LIV be willing to develop such an approach — apparently radical but in reality no more than evolutionary in recognition of its own considerable social impact — then it is also possible that LIV standing to challenge the general ethical standards of Government will acquire greater legitimacy. While the decision to continue to appropriate interest on clients' accounts is now primarily a decision of Government, an 'about turn' on this point by the LIV could only assist its public reputation as a moral leader and its ability to conscientiously assert the public interest. There will always be instances where Government actions have lacked ethical scrutiny through want of sufficiently untouchable *institutional* critics.[474] It is open to the LIV to assert an institutional duty to pay interest to the beneficial owners of the money. The community (and ultimately Government as well) would be the beneficiary of an 'ethically renewed' LIV.

[469] N Cowdery, 'Professionalism is the Best Defence' (March 1992), *Australian Law News*, 6–9.

[470] A survey of Victorian solicitors in 1993–94 showed higher levels of client satisfaction than might be expected.
See AH Evans, 'Acceptable But Not Entirely Satisfied: Client Perceptions of Victorian Solicitors' (1995) 20 *Alternative Law Journal* 57–62, which also lists other limited jurisdictional studies of client attitudes.

[471] S Parker, Australia, Parliament, Senate Standing Committee on Legal & Constitutional Affairs, *Cost of Legal Services and Litigation*, Discussion Paper No 5 — Legal Ethics, 2.

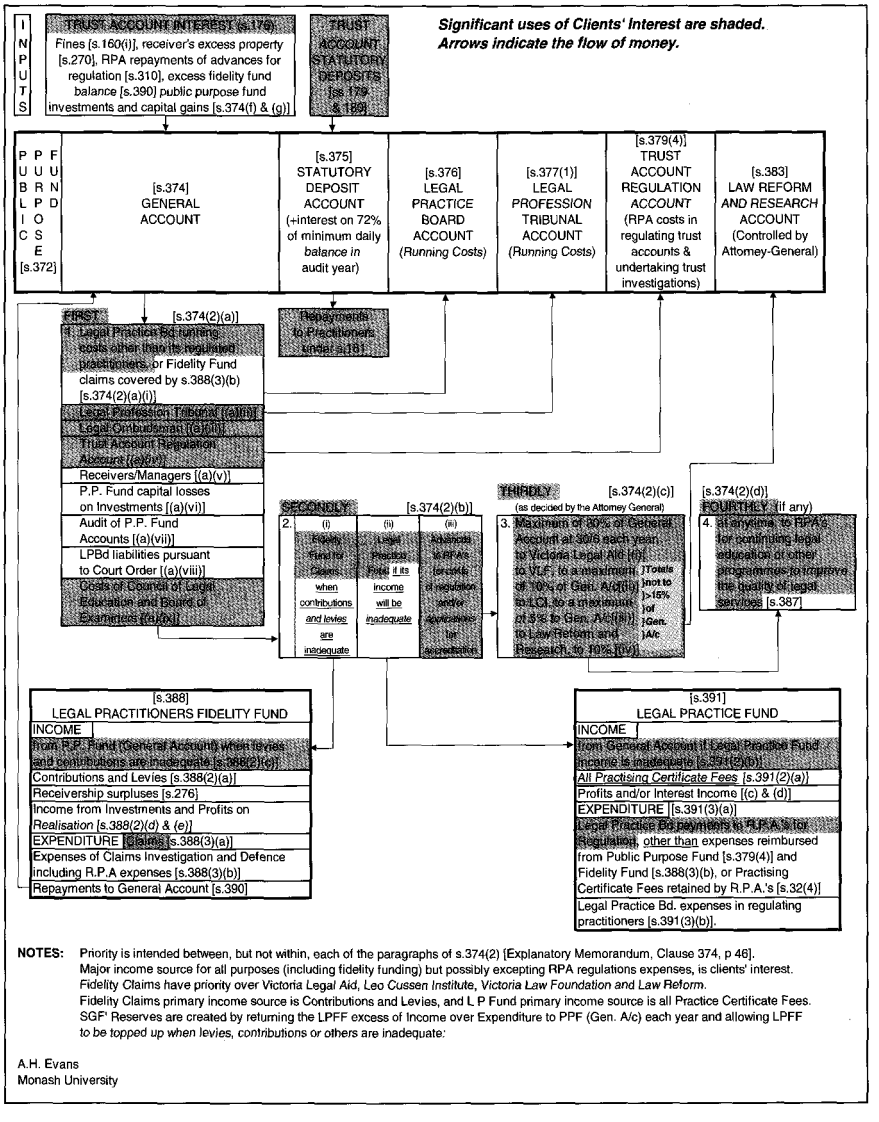
[472] Ibid.

[473] Sampford, above n 468, p 26.

[474] It is presumably accepted that '... the interests of Government do not exhaust the public interest'. See Preston, above n 468,10, quoting a 1992 speech by Sir Max Bingham, who was in turn making reference to an unspecified High Court judgment.

Appendix C

LEGAL PRACTICE ACT (VIC) 1996
TREATMENT OF INTEREST EARNED ON CLIENTS' TRUST BALANCES



NOTES: Priority is intended between, but not within, each of the paragraphs of s.374(2) [Explanatory Memorandum, Clause 374, p 46].
Major income source for all purposes (including fidelity funding) but possibly excepting RPA regulations expenses, is clients' interest.
Fidelity Claims have priority over Victoria Legal Aid, Leo Cussen Institute, Victoria Law Foundation and Law Reform.
Fidelity Claims primary income source is Contributions and Levies, and L P Fund primary income source is all Practice Certificate Fees.
SGF' Reserves are created by returning the LPFF excess of Income over Expenditure to PPF (Gen. A/c) each year and allowing LPFF to be topped up when levies, contributions or others are inadequate.

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