

**ARGUMENT OF THE BEVERLY HILLS BAR ASSOCIATION
IN FURTHER SUPPORT OF EMERGENCY LATE-FILED RESOLUTION
CONCERNING PROPOSED MALPRACTICE DISCLOSURE RULES**

The Beverly Hills Bar Association is pleased to present this argument in further support of its Emergency Late-Filed Resolution concerning the proposed mandatory malpractice disclosure rules.

Historical Background:

By amendment to Sections 6147 and 6148 of the Business & Professions Code effective January 1, 1993, the Legislature mandated disclosures of the existence or absence of lawyer's professional liability insurance ("LPL") coverage and, in certain circumstances, the policy limits of that coverage, in lawyers' engagement agreements. (Stats. 1992, ch. 1265, §§ 3-4.) In 1993, the Conference of Delegates approved a resolution proposed by the Beverly Hills Bar Association, joined by the Los Angeles County and Long Beach Bar Associations, calling for the repeal of the then-existing statutory disclosure requirements, because those disclosures were inherently deceptive to consumers. The Legislature tinkered with the disclosure requirements in an effort to remedy their inherent deficiencies, but added a sunset provision. (Stats. 1993, ch. 982, §§ 4-6.) After extending the sunset provisions at the behest of the State Bar, the Legislature ultimately repealed the disclosure requirements effective as of January 1, 2000. (Stats. 1996, ch. 1104, §§ 8-11.)

In 2004, the ABA House of Delegates narrowly adopted a Model Court Rule on Insurance Disclosure, mandating annual disclosure, by a lawyer to his or her licencing authority, whether or not the lawyer maintains LPL coverage. In response, in 2005 the State Bar established its Insurance Disclosure Task Force to consider the propriety of adopting the ABA model rule. The Task Force proposes not only that the State Bar and the Judicial Council do so, but that the State Bar re-adopt by rule a variation of the discredited client disclosure requirements previously imposed, and then repealed, by the Legislature.

The Board of Governors of the State Bar has circulated the proposed rules for public comment without recommendation. The State Bar has agreed to extend the comment deadline to permit this Conference to express its views on the proposed rules.

This Resolution:

Consistent with the position taken by the Conference of Delegates of the State Bar in 1993, this resolution urges the State Bar and the Judicial Council not to adopt the proposed rules. Instead of the proposed rules, this resolution urges the State Bar to determine why active members of the State Bar in private practice do not maintain lawyers' professional liability insurance coverage; to evaluate whether the establishment of a captive lawyers' professional liability insurance carrier would achieve coverage of all active members in private practice; and, if so, to propose the enactment of appropriate legislation.

The Problem:

These mandatory malpractice insurance proposals will disproportionately burden recently admitted attorneys and the attorneys who serve minorities, the legal aid-eligible population, and that

segment of the population ineligible for legal aid but generally unable to afford counsel. The reporting requirements in proposed Rule 950.6 accomplish little more than establishing a two-tiered bar and, absent full disclosure of the limitations and exclusions on coverage in the relevant policy or policies applicable to each attorney, will afford consumers of legal services cold comfort. Similarly, the negative disclosures to current and prospective clients proposed by Rule 3-410 are as likely to cause misinformation as to provide useful information to those clients.

Although the proposals would facially appear to be consumer oriented, in effect they will increase the costs of legal services. Lawyers will have little choice but to obtain coverage or be branded. This negative branding has little relationship to competent delivery of legal services and will unduly impact small-firm and solo practitioners, whose practices may be unable to support the premiums required by carriers for meaningful professional errors and omissions coverage.

In effect, the proposals will impair the ability of those lawyers least able to afford coverage to continue in practice, possibly driving some out of the practice of law. Those are the very lawyers who are most likely to provide legal services to minority clients and the otherwise unserved and underserved segments of the population. Therefore, these disclosure proposals will adversely affect access to justice. A bar with almost 155,000 active members (lawyers eligible to practice without restriction) should be able to mandate a policy for all its members, rather than a policy which functionally exempts large firms and powerful attorneys and targets small firms and solo practitioners.¹

These proposed reporting and disclosure requirements will be unduly burdensome and misleading. In addition to the initial report and disclosures upon adoption of the rules and the initial negative disclosure at the time the lawyer is engaged, if a lawyer who originally is covered subsequently ceases to be covered, the lawyer must inform each client of the loss of coverage, in writing, within 30 days of the loss of coverage.

The mechanics of this proposed rules will be a severe shock to those lawyers who are currently without coverage. There not only will be the time and cost involved in notifying clients, but also the backlash when clients, receiving a notification that their attorney is not covered by insurance, decide to seek new counsel. The process becomes more onerous when initial or replacement malpractice coverage is difficult to obtain or is accidentally dropped and additional notices need to go out to the client.

If this weren't enough of a burden on the lawyer without malpractice insurance, the lawyer must also be concerned about the possibility of a gap in coverage – either when obtaining coverage and failing to obtain “nose” coverage² or when switching carriers. The failure to notify clients of such a gap, which may not be clear to the practitioner at the time it occurs, may subject the lawyer to suspension as called for by the rule. It also may give the malpractice plaintiff an unexpected bonus

1. In addition, the proposal applies without exception to every member who is representing clients, wherever the member may be located, without regard to where the client may be located. Thus, the proposal applies to the 18.3% of the State Bar membership who practice outside California and may be subject to different and/or inconsistent obligations in their “home” jurisdictions.

2. Coverage for errors and omissions occurring before the effective date of the policy, which requires an endorsement and a potentially substantial additional premium.

(the violation of the rule and a breach of fiduciary duty claim for failure to disclose the limitations on coverage) when suing.

The most important obligation lawyers owe their clients is honesty. The proposed mandatory disclosure of the mere existence or non-existence of malpractice coverage is antithetical to the fundamental fiduciary duty of honesty. The proposed mandatory disclosures fail to explain the intricacies of insurance coverage, and "public education" groups will not solve the problems created by the current proposal. Further, the proposed mandatory disclosures may create a false sense of security that will engender a host of unintended consequences.³

Is the public going to understand that policies typically are issued on a hybrid "claims made/occurrence" basis, so that coverage is triggered only when a client complains – but even then exists only if the claim also arises when the policy is in force absent "nose" coverage [a prior-acts endorsement]? What about exclusions, deductibles, "PacMan" Clauses,⁴ and other issues involving policy lapses? Professional errors and omissions coverage is an extremely complicated issue. Although the proposal may look good on the surface, what assistance does it really provide to the consuming public? Simply mandating disclosure begs these and a number of other important questions.

It is important to remember that coverage has nothing to do with the acts of dishonest lawyers, because intentional misconduct cannot be covered by insurance.⁵ For example, the media recently has been fixated on allegations of illegal wiretapping at the behest of members of the legal community. Obviously, those acts will not fall within the penumbra of a law firm's coverage, but will the carriers also disclaim coverage for innocent partners of the firms, who knew or should have known what their miscreant partners were doing?

While efforts to mandate these types of disclosures are in vogue, it is important to note that the Rules Revision Commission (Ethics 2000) of the American Bar Association rejected the concept of mandatory disclosure in its proposed amendments to the Model Rules of Professional Conduct.⁶

3. Given the principle in fiduciary duty law that any disclosure, if made, must be sufficiently complete as not to be misleading, a requirement that a lawyer disclose to a prospective or continuing client the "absence" of LPL insurance, if there is no coverage for any part of the lawyer's engagement, despite the existence of an LPL policy otherwise covering the lawyer, the lawyer arguably would have to disclose that fact as well, with a discussion of the reasons for the exclusion (which may be beyond the particular lawyer's competence, thus arguably necessitating the engagement of coverage counsel for the purpose of making the disclosure). Those are unnecessary and unwarranted burdens to impose on any lawyer.

4. Clauses permitting costs of defense of a malpractice claim to diminish liability coverage limits.

5. This is an express public policy position of the State of California, stated in the Insurance Code. That said, injuries from intentional misconduct already are addressed by the Client Security Fund, which will not be affected by this proposal.

6. After that proposal was rejected, at its 2004 Annual Meeting, the ABA House of Delegates did adopt (by the very narrow margin of 213-202) the proposed Model Rule on Insurance Disclosure (Recommendation 108), revised "to harmonize the rule with respect to states which already have such a rule," over the objection of the ABA Standing Committee on Lawyers' Professional Liability (the "LPL Committee") and the objection of various members of the California Bar. (See Report on the ABA Annual Meeting (August 23, 2004) at 13, available at <http://www.abanet.org/leadership/2004/annual/>

The existence of coverage has little to do with a lawyer's recognition of fiduciary obligations, with which the organized bar is supposed to be concerned. Lawyers are one of the few remaining self-regulating professions.

A secondary, less vetted, level of lawyer regulation is effectuated independent of the statutes and rules governing lawyers; it is imposed by carrier exclusions.⁷ For example, serving on a board of directors or as an officer of a client or even a non-profit organization can be excluded, as can joint client/lawyer investments or acquisitions. Under the Rules of Professional Conduct, those activities are permissible, so long as certain formalities are satisfied. Nevertheless, carriers can deny coverage to policy holders if they engage in them. Is it good for our clients for carriers to be increasingly involved in the regulation of the legal profession? Generally, the states that have regulations involving disclosure and/or coverage are small and have relatively homogeneous lawyer populations. By contrast, states with large populations of lawyers, with varied types of legal practice, do not mandate disclosure.⁸

Annual premium rates range anywhere from around \$4,000 to \$7,000 or more per lawyer, depending on a lawyer's practice area and the amount of coverage requested. Some areas of practice, such as patents and class actions, are almost uninsurable.

Because California has an enhanced disciplinary system, with full time State Bar Court judges, which is funded at a cost of more than \$40,000,000 a year, issues of lawyer misconduct are vetted at the State Bar and are fully resolved in that system. The issues investigated by the California disciplinary system include the leading predicates for claims of professional negligence, such as poor communication, calendaring problems, and suing a client over a bill – issues unrelated to the existence or absence of LPL insurance coverage. The proponents of these proposals offer no evidence that the same conditions exist in California, with its unique disciplinary system, as may justify these requirements in other states.

SelectCommitteeReportFINAL.doc.) As stated in the Executive Summary of the Report accompanying Recommendation 108:

The LPL Committee . . . believes that the topic of lawyers' professional liability insurance is complex and unfamiliar territory for most of the public and many lawyers. Given the nature of claims-made coverage, the LPL Committee believes it is likely that the general public's idea and expectations of what "insurance coverage" means at the time a client hires a lawyer is much different than actual reality. Therefore, simply telling a client that insurance coverage exists at the time of hiring can be tantamount to telling the client nothing.

(Available at <http://www.abanet.org/leadership/2004/execsumm04.pdf>.) In January of this year, the Arkansas Bar rejected adoption of the Model Rule.

7. See Davis, Anthony E., Professional Liability Insurers as Regulators of Law Practice, 65 *FORDHAM L. REV.* 209 (1996).

8. New York, Texas, Florida, New Jersey, et al. (See chart detailing state implementation of Model Rule (8/11/06), available at the website of the ABA Standing Committee on Client Protection; see also Report of the Committee on Professional Responsibility of the Association of the Bar of the City of New York to the Chair of the ABA Task Force, available at www.abcnyc.org/pdf/report/victor_report2-b.pdf.)

Simply stated the proposed rules will do nothing more than invite malpractice suits by dissatisfied clients, who will view their suits as nothing more than a way to extract money from an LPL carrier without regard to the consequences to the lawyer.

The Beverly Hills Bar Association urges you to support this resolution and, by so doing, to communicate to the State Bar the rejection of the proposed rules by the voluntary bar associations of this state, on behalf of all California lawyers in private practice.