

Should Disclosure of Malpractice Insurance Be Mandatory?

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If you apply to the state where you live for a vehicle registration, virtually every state will require that you show proof of financial responsibility, usually in the form of proof of insurance. Similarly, apply to your state for a contractor's license, and again, you will be required to show proof of insurance. The reason for these requirements is simple and common sense: To obtain a state license, you must demonstrate that you have the ability to protect the public if anyone is injured by your negligence in your use of that license.

However, if you apply to your state for a license to practice law, you will have to pass a bar exam and demonstrate good moral character, but you will *not* be required to prove that you have malpractice insurance. And if you are negligent in using your license to practice law, and, as a result, one of your clients is injured, well, that's the client's tough luck.

This is one of the dirty little secrets of the legal profession: No state (except for Oregon, more on that later) requires that lawyers in private practice demonstrate proof of financial responsibility. One of the ironies of the situation is that many clients no doubt presume that all lawyers are required to carry malpractice insurance. Clients often discover the fallacy of that assumption for the first time when they attempt to sue their uninsured lawyers.

However, there has been an encouraging trend recently, led by state supreme courts rather than by bar associations. That trend is the adoption in several states of rules of professional conduct that require a lawyer who lacks professional liability insurance to disclose that fact to every client.

Although the organized bar has taken an ostrich-like approach to this issue, the problem of uninsured lawyers is a real one. Estimates vary, but most experts in legal malpractice insurance believe that one-third or more of American lawyers in private practice are uninsured. The question then becomes, is this a problem that needs to be addressed? Surprisingly, the response from the organized bar has largely been that the problem should be ignored.

The Oregon Model of Mandatory Insurance

Of all the jurisdictions, only Oregon has squarely addressed the issue. Since 1978, Oregon has had mandatory malpractice coverage for all lawyers in private

practice, through the Oregon State Bar Professional Liability Fund. This fund affords minimal levels of \$300,000 coverage per occurrence, at a current premium of slightly more than \$2,000 per year. Oregon's fund has worked well and protected clients of all Oregon lawyers from the risk of un-insured losses.

However, there are sound reasons to question whether Oregon's model would work well in other jurisdictions. The Oregon fund was established at a time when the insurance markets were far more favorable than they are today. Approximately 7,000 lawyers in private practice are covered by the Oregon fund. It is unlikely that this model would work as well in a state like California, which has more than 120,000 lawyers in private practice and a far greater diversity in types of practice and risk levels. The concern is that if proper insurance underwriting were used in a mandatory plan in a state like California, premium levels would be prohibitive for many lawyers, especially those in solo or small firms or those with limited incomes from their legal practice.

Mandatory Disclosure of Lack of Insurance

An alternative approach to the issue of uninsured lawyers is to require such lawyers to disclose to their clients their lack of insurance. California first adopted this approach in 1988 by including such a disclosure in written fee contracts, as required by California Business and Professions Code Sections 6147 (contingent fee contracts) and 6148 (hourly and other fee contracts). As originally enacted, the California statute required an affirmative disclosure by all attorneys as to whether they carried malpractice insurance.

In the early 1990s this was amended to require a written disclosure only by those attorneys who lacked insurance. The California statute worked well, with a minimum of complaints from lawyers. However, that statutory requirement sunsetted at the end of 2000, and it has not yet been reenacted.

In 1999 the Supreme Courts of Alaska and South Dakota broke new ground in this area. Both courts adopted modifications of their Model Rules of Professional Conduct that mandated disclosure of the lack of malpractice insurance. In Alaska, for example, Model Rule 1.4 regarding communications was amended to require that a lawyer notify a client in writing if the lawyer had no insurance or insurance of less than \$100,000 per claim or \$300,000 annual aggregate, or if the lawyer's insurance was terminated. The South Dakota rule amended Rule 1.4 to require a similar communication to clients as a component of a lawyer's letterhead.

Anecdotally, it must be reported that, after the adoption of these rules in Alaska and South Dakota, the lawyers reacted in a predictable fashion. A significant number of lawyers who had previously been uninsured obtained malpractice insurance shortly before the effective date of the new rules. In other words, the new rules provided a positive incentive for uninsured lawyers to obtain insurance, so that they would not be required to make to clients the disclosure of lack of insurance.

In April 2001, Ohio joined this trend. The Supreme Court of Ohio voted (in a 5-2 decision) to amend the Code of Professional Responsibility to require lawyers who lack malpractice insurance to notify their clients of that fact using a standard form. The New Hampshire Supreme Court adopted a similar rule, which became effective on March 1, 2003, requiring disclosure to clients of lack of insurance. The Nebraska Supreme Court is also studying a proposed rule. In addition, the Virginia Bar has a rule requiring that lawyers report to the state bar whether they have malpractice insurance. In 2002 the Virginia Bar decided to put that information online to make it more accessible to the public. More than 25,000 hits were received on the bar's website within the first week after that information was posted.

As a result of the movement of these various courts to require mandatory reporting, in 2000 the ABA Standing Committee on Client Protection decided to propose a similar amendment to the ABA Model Rules. The Standing Committee requested that the Commission on Evaluation of the Rules of Professional Conduct (Ethics 2000) include such a provision in the Ethics 2000's general overhaul of the ABA Model Rules, but Ethics 2000 declined the invitation. After encountering some opposition from other ABA entities and a general lack of support, the Standing Committee on Client Protection elected not to forward any such proposal to the ABA House of Delegates.

Objections to Mandatory Reporting

As the debate on this issue of mandatory reporting has spread during the past several years, opponents have voiced a variety of objections to the concept. Some objections are philosophical, others are technical in nature.

One of the most frequent objections is to question the need for such a rule. Where is the evidence that uninsured lawyers are currently harming clients? Where is the evidence of malpractice judgments that are uncollectible owing to lack of insurance? It is a fair criticism that no study exists providing data on these points. The entity within the ABA that most logically could conduct such a study, the Standing Committee on Lawyers' Professional Liability, has never conducted one.

However, a study is hardly necessary to demonstrate that client harm results from uninsured lawyers. Without question, lawyers who lack insurance commit malpractice, just as do those with insurance. And no one can seriously question that claims against uninsured lawyers are often abandoned, precisely because there is no available insurance. If you doubt this, simply ask any lawyer in your community who handles plaintiff's legal malpractice claims about the subject. Such a lawyer will tell you that in evaluating whether to file such a claim, a threshold issue is whether the lawyer is insured. If the claim is modest (i.e., with potential damages of \$100,000 or less), many plaintiff's malpractice lawyers will elect not to file suit; the risk that any judgment will prove to be uncollectible, in light of how difficult these claims are in other respects, simply makes such claims not worth pursuing. It is difficult to count claims never pursued owing to lack of insurance.

Another objection to mandatory reporting is the suggestion that client security funds already address the issue. That is simply not the case. Client security funds have a more limited purpose: to reimburse clients when lawyers steal money. The rules of client security funds do not permit reimbursement for simple acts of negligence by a lawyer. Malpractice claims are the only manner by which a client can seek redress for simple acts of negligence.

One technical objection is that mandatory disclosures don't include the nuances of the adequacy of the legal malpractice carrier or the issue of when a diminishing limits policy (where liability coverage diminishes as expenses of defense are incurred) causes coverage to fall below a certain level. It is true that such nuances are not covered by many of the mandatory disclosure rules. Certainly such factors should be considered in drafting disclosure rules. However, these are not compelling arguments for failing to address the problem at all. An imperfect solution to the problem of uninsured lawyers is better for the public than no solution at all.

Conclusion

Law school professors commonly offer the warning, "Allow me to frame the question, and I will dictate the answer." In the debate over mandatory reporting rules for uninsured lawyers, much depends on how the question is framed.

Supporters of mandatory disclosure frame the question as follows: When a client hires a lawyer, is the lawyer's lack of insurance a material fact that the client is entitled to know? It is difficult to fashion a persuasive argument that clients are not entitled to that information. Lawyers operate under a state license and have a monopoly on practicing law. With that monopoly go certain obligations. Full disclosure to clients of material information regarding their representation is certainly one of those obligations.

And if you don't believe that most clients would consider information about lack of insurance to be material, I suggest you put that question to a cross-section of your own clients. You may be surprised by the response.