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MEMORANDUM

TO: **State Bar of Texas Board of Directors**

FROM: **David J. Beck, Chair**

DATE: **June 11, 2008**

RE: **Task Force on Insurance Disclosure**

I. Introduction

State Bar President Gib Walton appointed the Task Force in early November, 2007. The Task Force was comprised of 13 members, whose respective practices were from firms of varying size. In addition to the Chair, the Task Force members are Kim Askew (Dallas), David Brown (Houston), Ron Bunch (Waxahachie), George Edwards (Public Member/Houston), Chuck Herring (Austin), Jo Ann Merica (Austin), Bill Miller (Texarkana), Mark Osborn (El Paso), Lee Ann Reno (Amarillo), Gary Reaves (Keller), Eduardo Rodriguez (Brownsville), Fidel Rodriguez (San Antonio), and State Bar staff member Ray Cantu. President Gib Walton served as a non-voting, ex officio member. Two of the Task Force members are from the State Bar's General Practice, Solo, and Small Firm Section.

Our mission was, after appropriate due diligence, to make a recommendation to the State bar Board of Directors whether Texas should require Texas lawyers to disclose the existence or non-existence of professional liability insurance, and, if so, the form of any such disclosure.

II. Background

The issue presented is not without controversy. In August of 2004, the ABA House of Delegates approved a new Model Court Rule on Insurance Disclosure by a thin margin of 12 votes (213 "for" and 201 "against"). Under the ABA Model Rule, lawyers would be required to inform their state supreme court (or other designated entity) whether they maintain insurance, and that information is thereafter made available to the public.

Our first meeting was held on December 21, 2007 in Austin, Texas. In addition to organizing the efforts, the Task Force quickly determined that substantial additional information was needed. As a result, we sought to determine more information regarding the approaches taken by other States with respect to the same issue, whether any increase in insurance rates resulted in those states where disclosure was mandated, whether the rate of legal malpractice claims versus uninsured attorneys was affected, and whether any increase in legal malpractice claims occurred in those states where disclosure was mandated. Moreover, we communicated directly with the American Bar Association (ABA) and various State Bars, including California and Virginia, to learn more about their approach to the disclosure issue and its effects.

At present, twenty-four (24) States require some form of insurance disclosure by attorneys. Those States are Alaska, Arizona, California[1], Delaware, Hawaii, Idaho, Illinois, Kansas, Massachusetts, Michigan, Minnesota, Nebraska, Nevada, New Hampshire, New Mexico, North Dakota, North Carolina, Ohio, Pennsylvania, Rhode Island, South Dakota, Virginia, Washington, and West Virginia.

The specific approach taken by the states has varied. At least five (5) of the states with an insurance disclosure requirement have amended their Rules of Professional Conduct to require attorneys to disclose *directly* to their clients if the attorneys do not maintain a minimum level of professional liability insurance (Alaska, New Hampshire, Ohio, Pennsylvania, and South Dakota). Kentucky was considering a proposed rule following this approach, but the Kentucky Supreme Court rejected that proposal in 2006. Consequently, a new insurance proposal is currently under consideration in Kentucky.

Sixteen (16) of the states with an insurance disclosure requirement have followed the ABA model, and require attorneys to disclose *on their annual registration statements* whether they maintain professional liability insurance (Arizona, Delaware, Idaho, Illinois, Kansas, Massachusetts, Michigan, Minnesota, Nebraska, Nevada, New Mexico, North Carolina, Rhode Island, Virginia, Washington, and West Virginia). In fourteen (14) of those states, the information is made available to the public, in some cases by posting on the State bar website, but in others the information is disclosed upon inquiry only. In two of those states, the information is not made available to the public. Three other states are presently considering the approach of the ABA model (New York, North Dakota, and Vermont).

[1] The California Supreme Court still must approve the approach recently adopted by the State Bar Board of Governors.

Utah has not adopted a rule, but the Utah Supreme Court issued an order, upon a petition filed by the Utah State Bar, that specifies inclusion of malpractice insurance questions on the attorney licensing forms for the 2007-08 and 2008-09 licensing years. Those questions must be answered for the licensing form to be accepted as complete. The information provided will be for the use of the Utah Supreme Court and the Utah State Bar, and will *not* be made public.

The House of Delegates of the Arkansas Bar Association voted *not* to adopt an insurance disclosure rule. The proposal, which would have followed the ABA Model Court Rule, was approved by the Bar's Board of Governors, but was defeated in the House of Delegates by a vote of 29 against to 14 in favor, with about 12 abstentions.

Oregon remains the only state that requires lawyers to carry malpractice insurance.

South Dakota has had a rule requiring direct disclosure to clients for ten years. South Dakota also has a requirement for lawyers to file an annual report which states whether they have professional liability insurance. There is no empirical evidence that indicates the percentage of South Dakota lawyers with malpractice insurance prior to the adoption of the rule, although they suspect it was around 80%. Since adoption of the rule, just over 96% maintain malpractice insurance as reflected in the annual filings. South Dakota has neither noted any increase in malpractice claims, nor an increase in the cost of legal services since requiring disclosure.

III. The Surveys

As part of our due diligence, we surveyed Texas lawyers by email to obtain their views on the subject.[2] 77% of the attorney-respondents were *against* disclosure of whether they carried professional liability insurance. A subsequent telephone survey of attorneys was also conducted. 65% of the attorney-respondents believed that Texas lawyers in private practice should *not* be required to disclose whether they carried professional liability insurance.

Thereafter, we commissioned a random survey of members of the public. The results were just the opposite of the attorney survey results. 70% of those responding believed that lawyers *should* be required to inform a potential client whether they carried professional liability insurance. An even higher

[2] The results of all the surveys were reported to the Board at its recent meeting in San Antonio. It is our understanding that the response rate of 6.6% based on Bar Membership was typical for electronic surveys.

percentage (75%) of those responding believed that other professionals (such as doctors, architects, engineers, and accountants) also should be required do so.

IV. Principal Arguments Against Disclosure

A. There is no evidence of a problem

No evidence has been presented regarding the number of malpractice claims that remain unsatisfied due to lack of insurance or other available assets. In addition, clients do not base their decision to hire an attorney on whether the attorney has malpractice insurance. An attorney's competence to handle the client's legal matter is the most significant factor. If a client or prospective client wants to know whether an attorney has insurance, the client can always ask for the information.

B. Unfair impact on certain segments of the Bar

The proposal unfairly affects segments of the bar that are most likely to be uninsured. Those mentioned include solo practitioners, newly admitted attorneys, minority attorneys, and part-time attorneys.

C. Disclosure will stigmatize uninsured attorneys

Disclosure will unfairly stigmatize uninsured attorneys, and clients will draw unwarranted inferences from the absence of insurance. Even though disclosure does not mandate insurance coverage, it will compel attorneys to obtain insurance to avoid that stigma, and will place attorneys who elect not to carry insurance at an unfair competitive disadvantage.

D. There will be an adverse impact on access to justice

The required disclosure will have an adverse economic impact on consumers, and will adversely affect access to justice. When confronted with the added cost of malpractice insurance, attorneys will be faced with the dilemma of either passing that cost on to their clients or absorbing it themselves. If the cost is passed on, clients of solo and small firms in particular – including segments of the population who are least capable of affording legal services – will face an increase in the cost of legal services. If the cost is absorbed by the lawyer, the least prosperous portion of the Bar will become even less profitable and some may be driven out of the practice, leaving fewer choices for consumers.

E. Disclosure requirements will be misleading

Disclosure may actually mislead the public. Stating whether you "have insurance" is often not a "yes" or "no" answer. For example, given the claims-made nature of malpractice policies, having insurance at the time of the engagement may mislead the client into believing that coverage will be available when a claim is later made, which may not be true. Further, many claims made against lawyers will not be covered by any applicable insurance. In that case, the disclosure could actually create a false sense of security. In addition, attorneys who chose *not to* disclose the *absence* of coverage could be put at risk for allegedly misleading their clients about the *adequacy* of coverage, either implicitly or explicitly.

F. Malpractice lawsuits will increase

Disclosure will encourage malpractice lawsuits. Disclosure will encourage litigation against the *insured* attorneys, given the availability of an insurance recovery. The argument that no attorney will take a case against an uninsured lawyer (see V.B. below) would seem to confirm this argument. Alternatively, *uninsured* attorneys may be targeted by questionable malpractice claims for the purpose of forcing a quick settlement, given that personal assets will be at risk.

G. Other professionals don't disclose

No other professional is required to inform a client if he or she does not have professional liability insurance.

V. Principal Arguments in Support of disclosure

A. Absence of insurance is a material fact

The proponents of disclosure assert that the absence of professional liability insurance is material, potentially affecting the client's interest and decision about hiring a particular attorney. Clients have a right to know material facts in making a decision to hire an attorney. The disclosure requirements will have an adverse impact on uninsured attorneys only if one *assumes* clients with that information would not hire the attorney. If so, that confirms the material nature of the information.

B. Clients of uninsured attorneys often have no remedy

As a practical matter, clients may have no viable remedy when they have been damaged by an uninsured attorney's malpractice. Plaintiffs' attorneys usually will not take the malpractice case in such situations, because of the likelihood that there will be no monetary recovery.

Clients with claims against *insured* attorneys may have at least *some* potential recourse. While no client is guaranteed that he or she will prevail on a claim against an attorney or that a valid claim will be covered by insurance, clients with valid legal malpractice claims against insured attorneys have the opportunity of some recovery against some insured limit.

C. Disclosure enhances informed consumer decisions

The proposal will serve to inform clients when an attorney or prospective attorney is uninsured. By making that information available, a client will have better information to make an informed decision when choosing an attorney. Clients may *assume* attorneys have professional liability insurance, making disclosure even more important.

D. Failure of the system

Clients who learn after-the-fact that they have little or no recourse against an uninsured attorney whose mistakes have caused their losses do not believe they have been protected by the justice system and lose respect for, and confidence in, the legal system.

E. Disclosure protects the public

The State Bar should protect the public and demonstrate that it acts in the best interests of the public, not just attorneys. The unsuspecting client may be left without a remedy if an uninsured attorney commits malpractice. The client's interest should come first.

F. Failure to disclose the absence of insurance is a breach of fiduciary duty

Attorneys owe a fiduciary duty to clients. Failure to disclose the absence of coverage might be characterized as a breach of fiduciary duty.

G. The burden of asking should not be on the client

Clients may not have the level of sophistication to enable them to ask for all relevant information. The burden therefore should not be on the client to ask about an attorney's professional liability insurance. An attorney should have an affirmative duty to provide appropriate information to allow a client or prospective client to make an informed decision. That information should include a disclosure about liability insurance.

H. Protection of clients should be paramount

Attorneys are expected to offer protection to clients from adverse consequences. An attorney's pecuniary interests should not be placed above protection of the client. The client's interest in being fully informed about relevant circumstances outweighs any interest an attorney might have in not disclosing the absence of insurance coverage and is more important to the integrity of the Bar than allowing an attorney to remain silent on the issue.

I. Uninsured attorneys will not suffer a direct financial impact

The proposed rules are about disclosure. The proposed rules do not require attorneys to maintain insurance coverage, and therefore have no direct economic impact on uninsured attorneys.

VI. Recommendations

A. Considering the available information, and after due deliberation, the Task Force by a vote of 6 – 5 recommends that *no* insurance disclosure be required of Texas lawyers.

B. Since the Texas Supreme Court must eventually decide whether any disclosure requirement should be adopted, the Task Force also was requested to provide its views on the appropriate form of disclosure *if* disclosure were required. We therefore do so based solely on that assumption.

There are basically two types of insurance disclosure employed by the various states that require it: (1) disclosure directly to the prospective client; and (2) disclosure to the State Bar or Supreme Court for inclusion in their records or on their websites. South Dakota is perhaps the most extreme example of the first type of disclosure. In South Dakota, each lawyer is required to set forth on his or her stationery in bold print whether they do or do not carry insurance. Other examples of direct disclosure include statements in contracts of engagement, or other written documents furnished to prospective clients.

The Task Force recommends by a vote of 6 – 4 that any required insurance disclosure be set forth in an administrative rule (not a disciplinary rule), and that each Texas lawyer state in his or her disclosure whether the attorney does, or does not, carry professional liability insurance, and that this information be made available to the public only on the State Bar of Texas' website.