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PROFESSIONAL LIABILITY INSURANCE AS INSURANCE AND AS LAWYER REGULATION: RESPONSE TO DAVIS

*Charles Silver**

INTRODUCTION

ANTHONY E. Davis's article shows splendidly why law professors interested in professional responsibility or insurance law need contact with top-flight lawyers practicing in these fields. They have much to tell us. They know about cutting-edge developments and knotty problems. They have important factual and analytical insights to offer that can greatly enhance our work. They can also inspire us and keep us from deluding ourselves. Knowledgeable lawyers can steer law professors toward important projects and away from projects that are of little general interest or worth.

Clearly, Davis is a practitioner capable of doing all these things. He knows about recent changes in legal malpractice policies and about the underlying problems these changes are intended to address. He has thoughts about issues that lawyers and insurance companies have not yet faced fully, and he has ideas about how they may eventually address them. Finally, and perhaps most importantly, Davis has views concerning the role insurance companies currently play, may one day play, and ought to play in the regulation of lawyers. On these subjects, his article sends a wake-up call to professional responsibility teachers. Many of us know little about professional liability insurance, and most of us spend little or no time thinking about the impact of liability insurance on lawyers' behavior. If Davis is right in claiming that insurance-related considerations help explain why lawyers do and do not adhere to professional norms, and if he is also right in observing that insurance companies are restructuring the incentives and monitoring arrangements under which many lawyers work, then it seems obvious that professional responsibility teachers can no longer live in the dark. We need to find out what professional liability insurers are doing, why they are doing it, and whether they are motivating lawyers to act in appropriate ways.

If it is clear that we often need the help of able lawyers to do our work, it is less clear that they need our assistance to do theirs. In truth, we have much to offer them. We can do things with the data and insights they supply that they cannot, and by applying our tools to their problems, we can help them handle problems better. That is what I will try to do here. Having learned from Davis about develop-

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ments and problems in professional liability insurance, I will attempt to return the favor by examining some of his claims in light of basic insurance law and insurance economics.

I. Why Do Professional Liability Policies Exclude Coverage for Certain Kinds of Claims?

Davis contends at several points that liability carriers use coverage exclusions to discourage lawyers from engaging in risky conduct, including some activities the disciplinary rules permit.[1] For example, he points out that professional liability policies often exclude coverage for claims stemming from interest conflicts, office-sharing and support-sharing arrangements, lateral hires, law firm mergers, temporary lawyers, acts taken as officers and directors of clients' enterprises, and suits to collect unpaid legal fees. Yet, with suitable caveats, the disciplinary rules permit lawyers to engage in the conduct that generates the claims liability insurers refuse to cover. It follows, Davis contends, that carriers want lawyers to be even more cautious than the disciplinary rules require. They want lawyers to refrain from even permissible conduct likely to harm clients and foster claims.

I find Davis's proposed explanation unpersuasive. Insurers do not usually cite a desire to discourage risky conduct when justifying exclusions. They argue for exclusions on straightforward grounds having to do with their own interests. I cannot recall hearing a casualty company argue for a pollution exclusion—to pick a timely and important example—by citing a desire to discourage the manufacture, sale, storage, or distribution of pollutants. Most such discussions are couched in terms of the sizable costs pollution-related losses have imposed upon insurers. I would also question the soundness of an argument like Davis's were an insurer to make it. Because an exclusion eliminates an insurer's financial stake in risky conduct, it renders an insurer indifferent to the rate at which risky conduct occurs. If coverage for death stemming from rock-climbing accidents were excluded from life insurance policies, life insurance carriers would not care how much time policyholders spend climbing rocks. Perversely, carriers might even want policyholders to spend more time climbing rocks. The more time spent in this endeavor, the greater the likelihood that a policyholder will die from a rock-climbing accident rather than a covered cause.

Davis misses the point just made because he conflates the *justification* or *rationale* for an exclusion with the *effect* an exclusion is likely to have on the behavior of an insured. The justification for an exclu-

1. *See, e.g.*, Anthony E. Davis, *Professional Liability Insurers as Regulators of Law Practice*, 65 Fordham L. Rev. 209, 216 (1996) (discussing office sharing and stating that "Insurers are seeking actively to discourage, i.e., to regulate, conduct which the ethics codes and the ethics committees expressly endorse as proper, albeit with some reservations").

sion is ordinarily that, for a straightforward reason having to do with an insurer's self-interest or the economics of insurance, an insurer decides not to cover a particular peril, loss, or piece of property in a particular insurance policy. The effect of an exclusion is to saddle a policyholder with the cost of defending uncovered claims and paying related judgments and settlements. Davis understands the latter point full well. It does the work in his essay, the central claim of which is that exclusions in professional liability policies encourage lawyers to be concerned more about their clients and less about themselves by forcing lawyers to bear 100 percent of the risk of loss associated with claims arising out of selfish conduct.

When thinking about justifications for exclusions, it is important to take exclusions one at a time. Different exclusions often serve different functions. For example, some exclusions reflect nothing more than a market-based determination that few insureds are willing to pay for an omitted coverage. The decision to exclude liability coverage for losses arising out of the ownership of airplanes from homeowners policies probably rests on this ground. Few homeowners need this form of coverage, and those who do can easily identify themselves and purchase it separately. Therefore, coverage is excluded from the standard package, which sells more cheaply than would a policy containing airplane liability coverage. One can justify the exclusion without positing a desire on the part of insurance companies to discourage homeowners from owning or operating private planes.

The airplane liability example suggests a second innocuous reason for having an exclusion. Insurance companies frequently use exclusions to avoid providing duplicate coverages in different policy forms. Thus, homeowners package policies exclude coverage for losses stemming from the use of automobiles, even though most homeowners own automobiles and even though many insurance carriers underwrite both homeowners and automobile lines. The exclusion simply establishes that automobile policies, not homeowners policies, cover losses arising out of the use of automobiles.[2] Insurers often use exclusions to carve up the world of risks into discrete categories to which assignable policies apply.

It is plausible, indeed likely, that the innocuous purpose of carving the world of risk into discrete pieces accounts for some of the exclusions Davis identifies, although one cannot rule out the possibility that

2. Judges sometimes frustrate insurers' efforts to avoid duplicative coverages. For example, Peter Huber discusses a California Supreme Court case in which an insured's gun went off while he was driving, injuring a passenger. *See* Peter W. Huber, Liability: The Legal Revolution and Its Consequences 143-44 (1988). The Court determined that both the insured's automobile and homeowners liability policies covered the loss. This was a neat trick. The automobile policy expressly covered accidents arising out of the use of a car, and the homeowners policy expressly excluded accidents arising out of the use of a car. Whether or not the accident arose out of the use of a car, it would seem that at most only one policy applied. *Id.*

other purposes are operating as well. Consider the exclusion Davis says two carriers are using to eliminate coverage when a claimant seeks to hold an insured lawyer vicariously liable for the misconduct of another lawyer, or lay person, with whom the policyholder entered into an arrangement for the "joint marketing, promotion, advertising or conduct of their businesses."[3] The exclusion seems merely to reinforce the point, made several times in the standard policy form, that professional liability insurance covers only losses stemming from a lawyer's professional conduct. The policy does not cover losses arising from other activities in which lawyers engage. For example, it does not cover workers' compensation claims brought by law firm employees or claims asserted by clients who slip and fall on firm premises. To obtain coverage for these risks—and for risks attendant to joint marketing ventures with others—lawyers must purchase separate general liability policies, which insurers will gladly sell them. On this reading, the exclusion Davis is concerned about is simply a housekeeping measure designed to keep track of which policy covers what.

Another justification that seems to apply to some of the exclusions Davis mentions is the concern that lawyers will begin to act in excessively risky ways if certain losses are covered. This is the problem of moral hazard.[4] In a classic article, Mark Pauly cited moral hazard as the reason insurance companies refuse to offer first-party insurance covering 100 percent of medical care costs.[5] Responding to Kenneth Arrow, who contended that the failure to offer such coverage was an instance of market failure,[6] Pauly pointed out that insurance covering 100 percent of health care costs would encourage many insureds to purchase inefficiently high levels of medical care, care they would be unwilling to pay for if their own money was on the line.[7] It would be individually rational for an insured to purchase medical services whenever those services had a positive expected value for the insured, even when the marginal social cost of a service greatly exceeded the marginal private gain. The collective result of individually rational consumption would be gross overconsumption. The collective result would also be an ever-diminishing pool of insureds. Because premiums in excess of the risks faced by healthy insureds would be needed to cover medical costs incurred by the entire pool, healthy insureds

3. Davis, *supra* note 1, at 215.

4. For a wonderful introduction to and discussion of moral hazard, see Tom Baker, *Moral Hazard, Social Responsibility, and the Economic Analysis of Law: A Cultural History and Critique*, 75 Tex. L. Rev. (forthcoming 1996).

5. *See* Mark V. Pauly, *The Economics of Moral Hazard: Comment*, 58 Am. Econ. Rev. 531 (1968).

6. Kenneth J. Arrow, *The Economics of Moral Hazard: Further Comment*, 58 Am. Econ. Rev. 537 (1968) [hereinafter Arrow, *The Economics of Moral Hazard*]; *see also* Kenneth J. Arrow, *Uncertainty and the Welfare Economics of Medical Care*, 43 Am. Econ. Rev. 941 (1963) (discussing the special economic problems associated with medical care).

7. Pauly, *supra* note 5, at 534.

would have incentives to look for insurance elsewhere or to go bare. As the departure of healthy insureds caused the pool to shrink, premiums for remaining insureds would have to rise, giving the healthiest people still in the pool incentives to opt out and necessitating further premium increases. Thus did Pauly show that complete first-party health insurance coverage is impracticable, a point Arrow ultimately conceded.[8]

It is important to see the difference between a concern about moral hazard and the subtly different concern Davis identifies as explaining the existence of certain exclusions. Davis contends that insurers sometimes use conflict-of-interests exclusions to discourage lawyers from entering into as many conflicted representations as they do currently. This suggests that insurers are dissatisfied with how lawyers act at present. It is, therefore, not a concern about moral hazard, which is the fear that people would engage in too much costly conduct if they were insured. If the conflict-of-interests exclusions actually rest on a fear of moral hazard, Davis must recharacterize insurers' motivations.

It is easy to make the case that the conflict-of-interest exclusions reflect a fear of moral hazard. Suppose uninsured lawyers currently enter into conflicted representations likely to give rise to malpractice claims at rate θ, and suppose also that θ is the efficient rate. If these lawyers pay at least some attention to liability risks when accepting new matters, insurance against malpractice claims will predictably encourage them to undertake conflicted representations at rate $\gamma - \theta$ because it will insulate them from, all or part of, the costs of malpractice claims. Professional liability insurers thus face a moral hazard problem, a problem they may choose to deal with by excluding coverage for claims resulting from conflicted representations.

The preceding discussion shows that moral hazard is a problem when insureds control the level of risk. Because patients decide whether to purchase medical services, moral hazard is a problem for first-party health care insurers. Because lawyers decide whether to enter into conflicted representations, to hire laterals, to share office space with unaffiliated lawyers, to merge firms, to become part-owners or controlling persons in client-run enterprises, to employ temporary lawyers, and to sue clients for unpaid fees—all activities likely to generate claims—moral hazard is a serious problem for third-party professional liability insurers as well. A desire to limit the impact of moral hazard may account for many of the exclusions Davis discusses. Only when an insured does not control, or cannot easily manipulate a risk, can moral hazard be ruled out as a justification for a policy exclusion.

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8. *See* Arrow, *The Economics of Moral Hazard*, *supra* note 6, at 537-38.

An alternative to moral hazard that may explain many exclusions is the need to sort significantly different risks into separate risk pools. A well-designed risk pool aggregates a large number of independent exposure units with similar loss-producing characteristics. It is important to maintain the homogeneity of risk pools for at least two reasons. First, the law of large numbers works poorly when heterogeneous risks are lumped together, thus making it difficult for insurers to predict accurately the average rate and severity of losses for the pool. Second, because premiums are usually a function of the loss experience of an entire pool, low-risk insureds subsidize high-risk insureds when heterogeneous risks are grouped. This situation is unstable. It encourages adverse selection, as high-risk insureds, seeking the benefit of subsidization, try to get into pools with low-risk insureds.[9] It also encourages flight, as low-risk insureds, seeking premiums that more closely reflect their actual expected losses, opt into new pools or go bare.[10]

An example may be helpful here. Assume for the sake of argument that law firms and computer software companies are significantly different exposure units. This assumption seems reasonable. Software companies probably face far greater risks of copyright and trademark infringement than most law firms do and far less risk of committing legal malpractice. It should, therefore, be efficient for liability carriers to sort law firms and software companies into different risk pools. Insurers cannot accomplish that completely via the obvious expedient of creating one pool for law firms and another for software companies because lawyers and software producers have important real-world ties. Many lawyers represent software companies as clients. Some lawyers hold significant financial stakes in software companies, serve as their directors and officers, and help operate their pension funds. A liability claimant looking for a deep pocket may seize on one of these relationships in an effort to hold a law firm accountable for a

9. Concerns about adverse selection seem likely to justify exclusions and conditions relating to lateral hires, unaffiliated lawyers, temporary lawyers, and law firm acquisitions. Whenever a new lawyer joins or associates with an insured firm as other than an entry-level hire, a liability carrier must be concerned that the lawyer comes with baggage attached. The lawyer may be a bad apple whom the former firm expelled, or the lawyer may have changed firms to get away from bad apples left behind. Either way, the new lawyer is a source of risk for the new firm. Professional liability policies handle these risks by limiting coverage for vicarious liability and for claims arising out of prior acts, and by entitling insurers to revise coverage terms and premiums when law firms merge.

Group health care insurers encounter analogous difficulties. Laterally-hired employees may have been discharged by former employers who saw them as poor health risks, and workers with pre-existing but hidden medical conditions often change jobs to get better insurance benefits. Health care policies deal with these problems by excluding coverage for pre-existing conditions and by imposing waiting periods. These solutions are akin to the exclusions professional liability carriers use.

10. For an introductory discussion of the concepts in this paragraph, see George E. Rejda, Principles of Risk Management and Insurance 21-45 (4th ed. 1992).

software company's misdeeds. A suit against a law firm is, therefore, a potential link between a software company risk pool and a law firm risk pool; an insurance company must decide whether to tolerate this connection or sever it. If the link would cause an unacceptable level of heterogeneity in the two pools, the company may try to use a policy exclusion to break it.

Several of the exclusions Davis discusses can be justified as helping insurers maintain the homogeneity of law firm risk pools. For example, the exclusion for claims made "by, against or arising out of the conduct of any organization," other than the insured law firm, "which is owned, controlled, managed or operated by [a lawyer] or in which [a lawyer] is a partner or employee" seems clearly to serve this function.[11] It establishes that a professional liability policy covers risks associated with the delivery of legal services and not risks associated with undertakings of other kinds.[12] The exclusion serves the important purpose of sorting enterprises with different risks into different risk pools.

The exclusions for claims brought against lawyers in their capacities as directors and officers of other entities, as public officials, and as Employee Retirement Income Security Act ("ERISA")[13] fiduciaries probably serve the same risk-sorting function.[14] Other insurance policies cover losses stemming from these activities.[15] The effect of the exclusions may, therefore, be only to ensure that exposure units with different loss-producing characteristics are put in different risk pools.

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11. Davis, *supra* note 1, at 212.

12. *See, e.g.*, Smith v. Travelers Indem. Co., 343 F. Supp. 605 (M.D.N.C. 1972) (holding that a lawyer who invested money for a plaintiff was not covered under his professional liability policy for a claim filed on the lost investment because the lawyer was not engaged in providing legal services).

13. Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001-1461 (1994).

14. Mary E. McCutcheon, *Professional Liability Insurance Issues for Lawyers Sitting on Corporate Boards*, The Brief 8, 10 (Winter 1996) ("In recognition of the increased risk associated with dual representation, professional liability policies now contain exclusions relating to attorney/director liabilities."). The exclusions fail to separate the risk pools entirely, however, owing to the difficulty of distinguishing situations in which a lawyer acts as a lawyer from situations in which a lawyer acts in some other capacity. *See id.* at 10-11 (discussing difficulties inherent in distinguishing acts taken by lawyers with dual capacities).

15. *See, e.g.*, The Insurance Professionals' Policy Kit: A Collection of Sample Insurance Forms 422-29 (Alliance of American Insurers 1994-95 ed. 1994) (reprinting form directors and officers reimbursement indemnity insurance policy covering directors and officers for claims arising out of alleged misconduct in their official capacities); 1 Susan J. Miller & Philip Lefebvre, Miller's Standard Insurance Policies Annotated 449.0-450.4 (4th ed. 1995) (Form CGMIS § 31, the "Employee Benefits Programs Liability Endorsement" to the Commercial General Liability Policy, extending coverage to losses stemming from negligent acts and omissions committed in the administration of employee benefit programs); *see also* McCutcheon, *supra* note 13, at 10-11 (discussing coverages available for lawyers who serve on corporate boards).

The exclusion for ERISA fiduciaries is the clearest on this point. It voids coverage except when an insured lawyer "is deemed to be a fiduciary solely by reason of legal advice rendered with respect to an employee benefit plan."[16] In that event, the exclusion does not apply and the professional liability policy covers the loss. The exception neatly shows that the exclusion's purpose is not to eliminate coverage for risks associated with lawyering, which paradigmatically involves the rendition of legal advice, but to segregate lawyering risks from ERISA risks. By preventing professional liability insurance for lawyers from becoming errors and omissions insurance for ERISA fiduciaries, the exclusion prevents claimants, and lawyers seeking insurance coverage for ERISA-related claims, from converting one kind of policy into another, thereby cross-cutting risk pools.[17]

Sean Fitzpatrick, head of the lawyer liability section of Executive Risk Management Associates, an innovative professional malpractice insurer, suggests a related justification for the exclusions just mentioned. He points out that law firms want these exclusions to ensure that policies purchased to cover malpractice claims are not eroded by claims stemming from lawyers' involvements in outside enterprises.[18] Law firms often have difficulty monitoring the conduct of partners and associates who serve on company boards, and they do not want to be held accountable for other enterprises' mistakes. Some law firms deal with the problem by prohibiting their lawyers from serving on company boards. Others allow such activities but require lawyers who engage in them to obtain directors-and-officers coverage through the companies they serve or to obtain indemnification agreements from the companies themselves. The exclusions in professional responsibility policies are yet another weapon in the arsenal of law firms that have trouble dealing with lawyers' outside activities. The exclusions reduce the likelihood that a law firm will be sued as a result of a lawyer's participation in an outside enterprise, and they help make it clear that lawyers who serve on company boards do so at their own risk.[19]

In view of the many purposes exclusions can serve, I think Davis is too quick to lay the blame for so many features of professional liability policies at the feet of self-interested lawyers.[20] I hold this opinion

16. Davis, *supra* note 1, at 213.

17. The insuring clause serves the same function. It extends coverage to only liabilities incurred as a result of acts and omissions committed in the course of rendering professional legal services.

18. Telephone conversation with Sean Fitzpatrick, Lawyers Professional Liability Underwriting Manager, Executive Risk Management Associates of Simsbury, Conn. (Dec. 1995).

19. For support of Fitzpatrick, see McCutcheon, *supra* note 13, at 11.

20. An important alternative explanation suggested by Davis's article is the failure of courts to grant summary judgments on claims against attorneys. Insurers might react to this problem by taking steps to reduce the likelihood of claims, but such steps would not indicate any dissatisfaction with their lawyer-insureds.

partly because the features have plausible, alternative explanations, and for two additional reasons. First, liability insurers often act self-interestedly, and they are accustomed to dealing with self-interested others. The business of a liability carrier is to resist claims and minimize payouts. This business daily brings them into contact with plaintiffs' attorneys who are strongly, if not exclusively, motivated by the desire to earn fees. It also brings them into contact with policyholders who aggressively shop policies to find lower rates. Why should an industry so deeply immersed in self-interest condemn lawyer-insureds who go as far as the law allows in an effort to make an honest buck? Second, I think it unlikely that today's lawyers are more selfish than yesterday's lawyers were, and I wonder whether and why the interests of lawyers and clients should diverge more greatly today than they did before. Principal/agent problems are hardly new. They have existed since the first principal employed the first agent, and new incentive and monitoring arrangements are constantly evolving to handle them. As the danger increases that a lawyer will disserve a client, the joint interest the client and the lawyer have in handling that danger grows commensurately. I find it difficult to accept the idea, which appeals to Davis, that liability insurance contracts better encourage lawyers to act for the benefit of clients than do the contracts lawyers and clients negotiate between themselves.

II. Thoughts on the Relationship Between Professional Liability Insurance and Professional Responsibility

I began part I by distinguishing justifications for policy exclusions from effects of policy exclusions on the behavior of insureds. I then discussed the former to the exclusion of the latter. I did point out that Davis is interested mainly in how lawyers are likely to respond to exclusions. Reacting to a prior draft of this comment, Davis accepts the point and powerfully focuses attention on the importance of effects. He is perfectly right in contending that the effects of exclusions on lawyers' conduct should be studied even when a desire to influence the conduct of lawyers forms no part of the justification for an exclusion.

If effects matter most to Davis, it is fair to say that he is downright bullish about them. In keeping with his view that insurers are striving to discourage lawyers from engaging in self-interested conduct likely to foster liability claims, Davis believes insurance-generated pressures are all to the good. Thus, he boldly and optimistically predicts that "Insurers will accomplish what decades of drafting and redrafting ethics codes have failed to achieve, namely the effective elimination of conflicts of interest[s] from the practice of law, and the reassertion of the principles of fiduciary obligation over personal expediency."[21]

Wow! True or false, am I happy to hear this prognostication. Who, other than Davis, foresees a renaissance of professionalism? Most commentators who write about lawyers seem to think the profession is going to hell in a hand basket and yearn for the good old days.[22] Even Lester Brickman, a participant in this Symposium, and his fellow advocates of contingent fee reform, foresee the possibility of improving only the conduct of litigators, and their hope will be realized only in the unlikely event that Congress and the legislatures, judiciaries, or bar associations of the fifty states enact their proposal into law.[23] Davis stands alone in boasting that insurance markets will encourage all lawyers to serve clients better than they currently do.

Although I see things differently than both Davis and Brickman, I think they are unquestionably right about one thing. Codes of professionalism, mandatory continuing legal education programs, and innovative professional responsibility curricula are unlikely to motivate lawyers to serve clients more effectively or efficiently over the long haul. To improve the quality of lawyering, one must change the institutional structures in which lawyers operate, i.e., the incentives and monitoring arrangements lawyers work under on a daily basis. A good incentive structure or monitoring arrangement is worth a pick-up load of lawyers' creeds and disciplinary rules. It matters little whether an insurance company, a bar association, or a lawyer and client bargaining together is responsible for a particular structural arrangement. As academics concerned about maintaining professionalism and preserving lawyers' independence from lay regulation, we should know as much about incentives and monitoring arrangements as we do about ethics opinions and disciplinary rules.

Having agreed with Davis on the importance of incentives, I am convinced that he is wrong to predict the eradication of interest conflicts.[24] Conflicts will be a part of every lawyer's everyday life until the last lawyer retires. Because there are no conflict-free representations, lawyers will remain mired in conflicts as long as they have clients.

By stating that conflicts inhere in all representations, I am telling readers nothing new. A tenet of principal/agent theory is that agents' interests always diverge from principals' interests to some degree. Opportunities can arise in any representation for an agent to benefit

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21. Davis, *supra* note 1, at 226.

22. *See, e.g.*, Mary Ann Glendon, A Nation Under Lawyers: How the Crisis in the Legal Profession is Transforming American Society (1994) (discussing the problem of the contemporary legal profession and its effect on society's development).

23. *See* Lester Brickman, *ABA Regulation of Contingency Fees: Money Talks, Ethics Walks*, 65 Fordham L. Rev. 247 (1996).

24. This does not mean that I am pessimistic about the future of the profession, for unlike many others I am not convinced that the profession is in bad shape.

at a principal's expense. One can efficiently minimize an attorney's incentives and opportunities to subordinate a client's interests to his or her own, but one cannot efficiently arrange things so that attorneys will always find it in their self-interest to act as their clients would like.

If conflict-related exclusions in professional liability policies will never eliminate interest conflicts from the practice of law, what will they do? Some exclusions seem unlikely to have any impact on the rate at which lawyers enter into conflicted representations. That is true, for example, of the exclusion for claims made by, against or arising out of the conduct of organizations, other than insured law firms, in which lawyers hold ownership or management positions. It also seems true of the exclusion for claims asserted against lawyers acting in the capacity of officers or directors, public officials, and ERISA fiduciaries. These exclusions, like other housekeeping provisions whose purpose is to determine which policies cover what claims, do not prevent lawyers from purchasing coverage. They merely establish that lawyers who want coverage must purchase appropriate errors and omissions policies. Once covered by the right policies, lawyers should be as willing as ever to engage in the kinds of risky outside activities which, according to Davis, are likely to generate liability claims.

It is more difficult to predict the impact of the exclusion which, according to Davis, cancels coverage for losses stemming from "representations involving conflicts of interest[s] among multiple clients."[25] As written, the exclusion seems extraordinarily broad. It appears to void coverage for defense and indemnification costs generated by "[c]laim(s) arising out of the Insured's rendering or failing to render professional services to two (2) or more parties of divergent, varying, or opposed interests, thereby creating an actual conflict of interest."[26] I read this as excluding coverage for concurrent-client conflicts and former-client conflicts alike. If use of this exclusion were to become widespread, it surely would cause lawyers to sit up and take notice.

At present, the exclusion is a novelty, and it seems doubtful that it will become widely employed anytime soon. Although Davis describes the exclusion as being "currently used,"[27] it does not appear in the standard professional liability forms.[28] Moreover, none of my contacts in the industry had heard of it or thought they could sell policies containing it to their insureds. The market for casualty insurance is soft, and policyholders are taking advantage of prevailing conditions to press for lower premiums.[29] Although a few insurers may presently

25. Davis, *supra* note 1, at 213.

26. *Id.*

27. *Id.*

28. *See* 1 Miller's Standard Insurance Policies Annotated, Form PLLP2 (1995) ("Lawyers Professional Liability Insurance"—occurrence form); *id.* Form PLLP3 ("Lawyers Professional Liability Insurance (Claims Made)").

29. *See, e.g.*, Michael Bradford & Rodd Zolkos, *Buyers Celebrate Continued Soft Market*, Bus. Ins., Jan. 15, 1996, at 1 (reporting that the costs of insurance coverage

use the exclusion when selling policies to law firms with poor loss experiences or that are suspected of having unusually significant conflict-related exposures, it is premature to predict that the exclusion will soon be more widely employed.

Nor am I convinced that interest conflicts are so serious a problem for the legal profession that liability insurers cannot profitably cover them. According to the American Bar Association's study of malpractice claims asserted against attorneys from 1983 to 1985, conflicts of interests were alleged only 3.35 percent of the time.[30] Nearly half of these allegations were resolved without payment to the claimant,[31] and the amount paid to all claimants who alleged conflicts was only 3.41 percent of the total paid to all claimants.[32] I do not deny that these numbers are dated. Nor do I mean to imply that conflict-related losses are not actually far greater than the numbers suggest. I simply mean to ask whether there really is reason to fear that, insofar as conflicts are concerned, lawyers have run amok.

The ABA study also reveals that malpractice complaints assert negligence far more often than they do conflicts of interests. It is worth asking whether the availability of insurance covering negligence is the real culprit, and it would be interesting to speculate on the impact an exclusion for negligence would have on the way attorneys conduct themselves. We are not likely to see such an exclusion anytime soon as all parts of the bar would oppose it. Lawyers would object because a negligence exclusion would leave them without insurance for too large a part of their practices. Bar associations and consumer-protection groups would object because the exclusion would strip injured clients of protection.

The hypothesized objections to a negligence exclusion reveal a tension in bar associations' attitudes about professional liability insurance. On the one hand, bar associations want lawyers to buy lots of insurance. Some even make liability coverage mandatory. On the other hand, bar associations want lawyers to act properly. Although the two desires are logically compatible, one can still rightly accuse bar associations of wanting to have their cake and eat it, too. Insurance protects injured clients but it also weakens lawyers' incentives to

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continue to favor risk managers); Dave Lenckus et al., *Groundbreaking Market Softness: Early Surplus Lines Activity Was Unheard of Only Two Years Ago*, Bus. Ins., Jan. 15, 1996, at 4 (reporting that property/casualty rates remain favorable to risk managers).

30. ABA Standing Committee on Lawyers' Professional Liability, Characteristics of Legal Malpractice: Report of the National Legal Malpractice Data Center 6 (1989). These statistics are dated, and the methodology used to produce them is inadequately explained in the compilation. By citing them, I do not mean to imply that they are more than impressionistic. Also, it seems likely that conflict-related claims appeared under other headings, so the percentage of such claims may be far higher than the reported number.

31. *Id.* at 51.

32. *Id.* at 83.

exercise due care by freeing them from malpractice costs. One must therefore expect some insured lawyers to serve clients less well than the same lawyers would if uninsured. Bar associations should reflect upon this conflict before deciding to make professional liability insurance mandatory.

Bar associations should also study insurance economics before attempting to regulate the content of professional liability insurance policies. For example, after learning of the conflicts-of-interests exclusion, Mary Daly, a distinguished scholar of professional responsibility, observed that the exclusion is likely to discourage efficient multiple-client representations and asked whether bar associations should attempt to prevent carriers from using the exclusion.[33] It is difficult and perilous to answer Professor Daly's question without knowing why liability carriers use the exclusion. If they use it selectively when dealing with high-risk law firms, there is no obvious reason for bar associations to act. A decision to ban the exclusion might even be counterproductive, because insurance companies might then refuse to cover high-risk law firms. If insurers use the exclusion broadly, again a decision to ban it will have costs. Insurers may withdraw from jurisdictions that impose a ban. They may raise premiums for all law firms, causing some firms to purchase less coverage and others to go bare. If the exclusion addresses a problem of moral hazard, a ban may also encourage lawyers to enter into conflicted representations at an unacceptably high rate. Only when informed of these possibilities can a bar association sensibly decide to permit or prohibit use of the conflicts exclusion.

An interim step, and one likely to have better effects, would be for bar associations to emphasize the permissibility of conflict waivers and to encourage the development of law that insulates lawyers who obtain informed waivers from liability at the hands of disappointed clients. If, as Davis contends, insurance carriers are withdrawing from the conflicts arena because they cannot successfully defend conflicts cases even when lawyers obtain waivers,[34] the real culprit would seem to be the failure of judges to decide these cases on the law. Lawyers who obtain proper conflict waivers are entitled to have claims against them dismissed, and bar associations should clarify their conflict rules and their states' procedural rules to facilitate this result.

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33. Discussion with Mary C. Daly, Professor, Fordham University School of Law, in San Antonio, Tex. (Jan. 7, 1996).

34. *See* Davis, *supra* note 1 at 212, 225-26.