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PROFESSIONAL LIABILITY DEFENSE QUARTERLY

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INSIDE THIS ISSUE:

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SPECIAL POINTS OF INTEREST:

DUTY OF REAL ESTATE AGENT/BROKER TO INVESTIGATE PROPERTY CONDITIONS, BY: GLEN R. OLSON, ESQ.

An issue that frequently arises in real estate professional liability cases is the extent of the agent or broker's ("broker") duty to investigate the condition of property that is listed for lease or sale. In hot real estate markets buyers and lessees may move quickly on listings, structural or other problems with the property may be overlooked and the blame may then fall on the listing broker when such issues arise post-occupancy. The question then becomes whether the broker has the responsibility to investigate the condition of the property beyond the visual inspection typically applied in most transactions. The duty, as explained below, is heavily impacted by the laws of the state in which the transaction takes place, including the statutory disclosure requirements imposed on buyers, lessors and the real estate professional they retain.

In markets that have seen significant remodeling or redevelopment activity plaintiffs may urge that listing brokers have a duty to ensure that the relevant work was done pursuant to required building permits and consistent with applicable building codes. Most jurisdictions appear to reject this expansive duty to investigate, however, particularly as the sellers and lessors are making their own representations as to the condition of property, upon which the listing broker may typically rely. Buyers and lessees are also usually encouraged to conduct their own inspections although the opportunity to inspect property as fully as may be desirable can be undermined in markets where multiple bids are commonplace and deadlines to close escrow are short.

We discuss below three recent decisions that address this investigatory duty issue: *Mullins v. Mailloux,* 2017 WL 417465 (August 2, 2017), a decision out of the Superior Court of Connecticut, *Horiike v. Coldwell Banker Real Estate Brokerage Co.*, 15 Cal. 5th 1024, 210 Cal. Rptr. 3d 1 (2016) and *Peake v. Underwood* 227 Cal. App. 4th 428, 173 Cal. Rptr. 3d 624 (2014). While *Mullins* is an unpublished decision out of the Connecticut courts it is very well-reasoned and analyzes and distinguishes the California Supreme Court's decision in *Horiike*, explaining the factors relevant to when a duty to investigate should be imposed. *Peake* is an interesting cautionary tale: a case in which the plaintiff stepped over the line, asserted a duty the court found contrary to law and the relevant facts and

Continued on page 2

LETTER FROM THE PRESIDENT, BY: ERIN K. HIGGINS, ESQ.

Greetings to all from the home of the "almost but not quite" champion Patriots. To our members in Pennsylvania, congratulations on a great game. (On the down-low, I grew up in the Pocono Mountains, and my family in Pennsylvania could not have been happier about the outcome). Two weeks before the big game, the PLDF Board of Directors gathered for the annual board meeting, as curated by our indefatigable Executive Director, Christine Jensen. It was a very productive meeting. The Board discussed programming priorities for the PLDF Annual Meeting in October; a new membership initiative that you will be hearing about in the months to come; a plan for updating our web site; and ways to continue to improve the member experience for both our industry members and our members in private practice. We will continue to discuss these priorities and others during our monthly board conference calls. In oth-

Erin K. Higgins of **Conn Kavanaugh Rosenthal Peisch & Ford** LLP of **Boston**, Massachusetts, is President of PLDF. She may be reached at ehiggins@connkavanaugh.com.

Continued on page 22

REAL ESTATE AGENT/BROKER DUTY, CONT'D

which resulted in a sanctions award against the plaintiff.

In *Mullins*, the lessor (Mailloux) entered into an exclusive right to lease agreement with Berkshire Home Services New England Properties ("Berkshire") as to an apartment located in Vernon, Connecticut. Berkshire advertised the unit for rent at $1,050 per month, and was to be paid a $1,050 commission. On March 7, 2014, the plaintiffs entered into an Exclusive Right to Represent and Tenant Authorization Agreement with Berkshire essentially creating a joint representation by Berkshire of lessor and lessee. The plaintiffs' March 10, 2014 rental application was thereafter accepted.

While there were indications that there might be mold problems with the unit even before the lessees took possession, they occupied the property beginning in April 2014. In August 2014, however, they notified Mailloux that they were having health issues due to mold and moved out. The lessees then sued both Mailloux and Berkshire.

The *Mullins* plaintiffs claimed that their dual agency consent agreement with Berkshire created a fiduciary duty on the latter's part to investigate and warn of any hazards before plaintiffs occupied the premises. The plaintiffs contended that the relationship was more significant than that of a broker showing property to someone who then is injured during the showing. Berkshire moved for summary judgment, arguing that no duty to further investigate the condition of the property existed.

Plaintiffs' opposition to the motion relied upon *Horiike,* a case in which the California Supreme Court case affirmed the reversal of a nonsuit on whether the realtor had a duty to further investigate the size of property held for sale. In that action, the plaintiff was represented by a Coldwell Banker realtor as to the purchase of a luxury residence. The seller of the residence was represented by another relator from Coldwell Banker. As a result, the plaintiff and the seller signed a dual agency agreement with both realtors.

After purchasing the property, plaintiff Horiike learned that the actual square footage of the residence described in the building permits was significantly less than what the listing realtor had disclosed in marketing materials. He claimed that, because of the dual agency agreement, the selling agent owed a duty to the buyer which was breached by the misrepresentation as to the size of the residence. In particular, the plaintiff contended that the agent breached his obligation under the agreement to disclose known facts that materially affecting the value or desirability of the property.

The trial court in *Horiike* entered judgment for the selling agent instructing the jury that it could not find the defendant liable based on the selling agent's conduct, because the agent owed no duty to the buyer. 383 P.3d at 1099. On appeal, the plaintiff argued that the trial court did not properly evaluate the selling agents' responsibilities under the dual agency agreement. The Court of Appeal agreed with the plaintiff and held that a properly instructed jury could find that the agent breached his duty to the plaintiff by failing to communicate all of the material information that he knew about the square footage including the apparent contradictions between his marketing representations and the square footage measurements in the public records. *Id*. at 1099-1100.

The California Supreme Court agreed with the Court of Appeals, holding that the selling agent's duty to the plaintiff was no different than a buying agent's duty which is "to verify the accuracy of information transmitted to the buyer or to explain that it is unverified." 383 P.3d at 1103. The Court also observed that, pursuant to California Civil Code Section 2079.16, listing agents are required to disclose to prospective purchasers all facts materially affecting the value or desirability of a property that a reasonable visual inspection would reveal. *Id*. Specifically, section 2079.16(c) provides that a dual agent for both the sellers and buyers has a 'duty to disclose all facts known to the agent materially affecting the value or desirability of the property that are not known to, or within the diligent attention or observation of, the parties." Accordingly, the selling agent from Coldwell Banker owed a duty to Horiike, the plaintiff, to learn and disclose all facts materially affecting the value and desirability of the property. *Id*. at 1104.

> "[T]he selling agent's duty to the plaintiff [is] no different than a buying agent's duty which is 'to verify the accuracy of information … or to explain that it is unverified.'"

In the *Mullins* case, the plaintiffs argued that, as in *Horiike*, Berkshire owed them a duty to learn and disclose all material facts affecting their lease of the rental unit. This duty allegedly included the extent of any mold infestation at the property. The Superior Court found, however, that the Mullins' reliance on *Horiike* was misplaced for a number of reasons. First, the transaction in *Mullins* did not involve the sale of real estate but rather a one year rental for which Berkshire received a commission of only $1,050. The Court reasoned that the degree of investigation to be expected of a broker under such circumstances would naturally be less than that expected from a broker earning a significantly larger commission from a sale of a luxury home, "or any home for that matter." *Mullins v. Mailloux,* at *6.

Second, the Court observed that brokers' statutory obligations under California Civil Code Section 2079.16 were materially different than Berkshire's obligations under the dual agency consent agreement and Connecticut General Statutes Section 20-325g. While 2079.16 requires a broker to disclose all facts that materially affect the desirability of the property, section 20-325g, upon which the Mullins dual agency agree-

REAL ESTATE AGENT/BROKER DUTY, CONT'D

ment was based, simply requires a broker to disclose "information related to material property defects which are known to the brokerage firm and other information the brokerage firm is required to disclose by law." Thus, there was no requirement that the broker perform any investigation to increase his or her knowledge of the property. The court distinguished California Civil Code Section 2079 as requiring a broker to conduct a visual inspection of the property it lists and then complete a three page visual inspection report. The Superior Court also noted that, while the California Supreme Court had interpreted Section 2079.16, no Connecticut court had so interpreted Section 20-325g.

The *Mullins* court noted that there was no evidence in *Horiike* that the defendant actually had knowledge about the square footage discrepancy. Similarly, the plaintiffs in *Mullins v. Mailloux* had presented no evidence that Berkshire had actual knowledge of the presence of mold in the property prior to the rental. While one of the renters had testified that he noticed mold in three different areas he never pointed any of those conditions out to the Berkshire employee showing the property.

Thus, the Superior Court in *Mullins v. Mailloux* defined the issue as whether, as a matter of public policy, "the law imposes a duty on a broker to conduct an inspection for unknown hazards before a client it represents leases a property." Id at *7. Considering four factors the Connecticut Supreme Court has set out to answer this question, the court determined that such a duty would run counter to public policy.

First, the normal expectations of the parties would not be that a rental broker such as Berkshire would independently inspect or investigate unknown hazards in a rental unit. Second, the public policy of encouraging participation in the activity, while weighing the safety of the participants, did not support imposing a duty on real estate brokers to inspect for unknown defects. The Court noted that the availability of home inspectors and the availability of their clients to sue them for failing to properly perform their inspections, thus providing adequate protection for potential buyers and renters from unknown hazards.

Third, the Superior Court noted that the avoidance of increased litigation also weighed against imposing a duty on brokers to inspect. And, other than *Horiike*, the parties had cited no cases from other jurisdictions which have addressed the issue or persuasively argued for the creation of the duty to investigate. As a result, the Court granted Berkshire's motion for summary judgment.

Finally, one might assume from the *Mullins* and *Horiike* together that the California implies a broader duty to investigate on the part of listing or selling brokers, even in non-dual agency situations. However, as *Peake v. Underwood,* 227 Cal. App. 4th 428, 173 Cal. Rptr. 3d 624 (2014) illustrates, that is not the case.

In *Peake*, purchaser Joanne Peake bought a home from the sellers, the Underwoods. Approximately two years later she sued the Underwoods and their real estate agent, Ferrell, for damages arising from the defendant's alleged failure to disclose defects in the home's subfloor. 173 Cal. Rptr. 3d at 628-629. After approximately one year of litigation, Ferrell moved for terminating and monetary sanctions against Peake and her counsel arguing that the case was frivolous. The trial court agreed that Ferrell had met his burden to show that the claims were "without legal or evidentiary support" and that the continued maintenance of the lawsuit demonstrated bad faith warranting sanctions pursuant to California Code of Civil Procedure Section 128.7. The Court of Appeal then affirmed the sanction order.

The defect in question was a water intrusion incident whereby standing water was cause to wick into the home's foundation causing it and the attached flooring to deteriorate. Peake alleged that she only became aware of the extent of the water intrusion damage when her son's foot went through a bathroom floor after she purchased the home. She claimed that the sellers were aware of the problems and that the selling agent failed to: (1) conduct a competent and diligent inspection, and (2) disclose information about the true condition of the residence. Peake ultimately stipulated to strike all of her claims against Ferrell except her statutory claim for non-disclosure including non-disclosure under Civil Code Sections 2079 and 1102 et seq. 173 Cal. Rptr. 3d at 630.

In support of his sanctions motion, Ferrell contended that a real estate agent must disclose only visible defects and that the subfloor water intrusion problem was not visible on a reasonable inspection. In support of his motion he submitted the three page statutory transfer disclosure statement provided to Peake during escrow which set forth representations concerning the condition of the property including that the Underwoods were not aware of any flooding, drainage or grading problems. These were stated to be representations made by the sellers and not by the agent. *Id.* at 631.

Ferrell submitted a copy of his visual inspection checklist as an exhibit. In that visual inspection he had disclosed a soft spot in the subfloor of one bedroom and he referred the buyers to past inspection reports and a drainage upgrade report and work by a civil engineer. There was no dispute that Peake had received these documents and also that she received a physical inspection report which disclosed substantial problems in decay of the subflooring of the home.

Peake's theory in opposition to the sanctions motion

***PLDQ*'s Spring 2018 Issue**

We encourage member submission of articles pertinent to professional liability claims administration, defense trial advocacy, or professional liability substantive law. The manuscript deadline for the next issue is:

May 1, 2018.

"[T]he Superior Court noted that the avoidance of increased litigation also weighed against imposing a duty on brokers to inspect."

REAL ESTATE AGENT/BROKER DUTY, CONT'D

was that because the transfer disclosure statement Ferrell signed affirmatively represented that the property had no drainage problems and Ferrell "inexplicably checked "no" on that statement despite knowledge of such problems there was no basis for Ferrell motion. *Id.* at 632. Peake also argued that while the alleged defect was not visible and would not have been apparent during a reasonable property inspection, it was objectively reasonable for the plaintiff to seek an expansion of the scope of the disclosure statutes to require a brokers to "fully disclose facts which the broker knows, whether or not those facts could be revealed by a simple visual inspection" and that brokers should be required "to affirmatively disclose everything they knew about a specific property which may materially affect the value or desirability of that property." 173 Cal. Rptr. 3d at 637.

The Court of Appeal rejected this argument concluding that it was not founded on any reasonable legal principle. It specifically rejected expansion of section 2079 to of the Civil Code to cover the factual circumstances presented by the *Peake* case. The Court held that the trial court did not abuse its discretion in awarding the sanctions because the claims brought against the agent were frivolous and not objectively reasonable. *Id.* at 642-643.

While *Peake* involved a case where the relevant condition was arguably within the buyer's knowledge before the close of escrow, the Court examined in detail, and refused to expand, the parameters of the broker's duty to investigate. *Mullins, Horiike* and *Peake* cases each illustrate that the courts will focus on the specific statutory disclosure scheme in defining a broker's investigation and disclosure obligations. In many instances, those duties will be defined to include a visual inspection and a disclosure of known conditions derived from the seller or lessor.

Glen R. Olson is a partner of **Long & Levit** LLP, in **San Francisco**, specializing in professional liability and insurance coverage litigation. He defends lawyers, real estate agents, insurance agents and brokers and escrow agents. Glen may be reached at golson@longlevit.com.

LEGAL COLUMN: ARE LAWYERS PEOPLE TOO? ABA'S NEW ADVERTISING RULE PROPOSAL, BY: ALICE M. SHERREN, ESQ. AND DONALD PATRICK ECKLER, ESQ.

Since lawyers were first found to have the right to advertise in the mid-1970's state bars have heavily regulated, though not vigorously enforced those rules. With the emergence and near ubiquity of social media, lawyer communication with current and prospective clients has grown exponentially. On a recent trip to Florida, a state with among the most robust regulations on legal advertising, but with likely most of such advertising, there was a billboard marketing a traffic ticket firm's mobile application. Rules drafted even five years ago could never have been prepared for this.

Into this gap, the ABA, at the recommendation of the Association of Professional Responsibility Lawyers, has issued a proposed modification of the rules related to lawyer advertising. The current version of the draft, which was released on December 21, 2017, can be found at https://www.americanbar.org/news/abanews/aba-news archives/2017/12/aba_releases_propose.html. The ABA's proposal is based upon a report from APRL issued on June 22, 2015. https://aprl.net/wp-content/uploads/2016/07/APRL_2015_Lawyer-Advertising-Report_06-22-15.pdf

These proposals, which will be discussed further below, seek to liberalize and standardize rules related to legal marketing while maintaining and protecting the constitutional right of lawyers to advertise their services. There is some irony in the ABA proposing such rule changes in the wake of the addition of Rule 8.4(g) to the Model Rules that arguably chills lawyer speech in other areas, including in areas of public concern. What protection for commercial speech is afforded by the First Amendment has long been a subject of debate, while its protection of political speech has rarely been seriously questioned.

Short History of Rules Regarding Lawyer Advertising

In 1908, the ABA adopted the Canons of Professional Ethics that prohibited all advertising by lawyers. Following that, in 1969 the ABA created the Code of Professional Responsibility which maintained this policy. The first suggestion from the United States Supreme Court that lawyers might have constitutionally protected commercial free speech rights came in 1975, when the Court, in *Goldfarb v. Virginia State Bar*, 421 U.S. 773, 787-788 (1975), concluded that the practice of law is a business. After recognizing that commercial speech is entitled to protection in *Virginia State Pharmacy Board v. Virginia Citizens Consumer Council*, 425 U.S. 748, 765 (1976), the Court struck down a state imposed prohibition on lawyer advertising in *Bates v. State Bar of Arizona*, 433 U.S. 350, 384 (1977). Since that decision, the Supreme Court in *Central Hudson Gas & Electric Corp. v. Public Service Commission of New York*, 447 U.S. 557, 566 (1980), set forth a four part analysis, if the first two inquiries yield positive answers, the Court then turns to the third and fourth

> "These proposals … seek to liberalize and standardize rules related to legal marketing while maintaining and protecting the constitutional right to advertise … ."

ABA ADVERTISING RULE PROPOSAL, CONT'D

inquiries:

1. whether the expression is protected by the First Amendment because it concerns lawful activity and is not misleading;
2. whether the asserted governmental interest is substantial;
3. whether the regulation directly advances the governmental interests; and
4. whether it is not more extensive than is necessary to serve that interest.

Following that decision there have been several tests of this analysis, including in *Peel v. Attorney Registration & Disciplinary Commission*, 496 U.S. 101 (1990), which held that lawyers' letterhead was not misleading or deceptive where the certification and licensure referenced were both true and verifiable. The standard has become that commercial speech is not subject to ban or restriction where the advertising is not misleading advertising and to impose a regulation the regulator must present objective evidence to support the ban or restriction. See, e.g., *44 Liquormart, Inc. v. R.I.*, 517 U.S. 484, 503 (1996) ("Precisely because bans against truthful, nonmisleading commercial speech rarely seek to protect consumers from either deception or overreaching, they usually rest solely on the offensive assumption that the public will respond 'irrationally' to the truth.").

The Market for Lawyer Advertising and the Proposed ABA Model Rules

We rarely think of advertising as providing a service, but it does. Advising consumers of available services is essential for the market to work. This same principle applies to legal services. For good or for ill, many people would never know that they might have a cause of action if it were not for advertising by lawyers. With that information, consumers can then investigate whether they need such services. As a result, it is imperative that lawyer advertising, in whatever form it comes, be truthful.

Perhaps unintentionally, the proposed rules serve to encourage that market service by simplifying the regulations. The proposal cuts down the number of rules, eliminating Model Rule 7.5 in its entirety (moving it to the comments of Model Rule 7.1), includes a definition of "solicitation" that only includes personal contact, and provides that a lawyer may advertise through "any media." As has been the emphasis for some time, it is personal communication with unsophisticated potential clients that concerns bar regulators the most. In contrast, and in accord with the constitutional protections of commercial speech, these rules liberalize the regulation of the broadest definition of advertising by lawyers.

Concomitant with that simplification and a step back from significant regulation, the proposed rules would make both compliance and enforcement easier. If adopted, these rules would do away with the regulation and approval in some states of website, business cards, letterheads, and the like. In its study, APRL found that there are few bar cases brought against lawyers based upon a violation of the somewhat complex patchwork of advertising rules. As anyone with a television knows, these regulations have not served to curtail the amount of legal advertising available, but they have likely served to increase costs without substantial benefit to the public. The position of the drafters seems to be that arming potential consumers of legal services with more truthful information, while insulating them from direct solicitation, will yield better more informed decisions by those consumers.

How Should Defense Firms and Individual Lawyers Respond?

As with all ABA Model Rules, if these rules are accepted by the ABA, the speed of adoption by individual states is likely to be slow. Lawyers should monitor what their states do in this regard and comply with their states rules. If a lawyer practices in several jurisdictions, the lawyer should monitor changes to each state's rules. As the proposed changes simplify the standard, compliance will be easier upon adoption, but states rarely adopt the rule changes wholesale; there is often at least slight modification. As always, careful review of the rules governing professional responsibility is the best course of action.

Defense practitioners rarely use mass marketing techniques to advertise their services, but they do use websites, blogs, social media, and publications like this one to market their services. There is often integration among those media streams to attract web traffic through search engine optimization. Clear procedures should be established within the firm to review publications and control social media advertising. If marketing professionals are engaged by a lawyer or a firm, either as outside contractors or firm employees, their activities should be monitored pursuant to Model Rule 5.3. A lawyer could be found responsible for false or misleading information that is posted by a marketing professional.

The good news is that the APRL survey from June 2015 confirmed that complaints about lawyer advertising are rare, and that people who complain about lawyer advertising are more likely to be other lawyers rather than clients. In addition, ethics boards are more likely to handle complaints relating to advertising informally, with a focus on correcting how the advertising violates ethical rules. Many ethics boards have regulatory staff address such complaints by seeking voluntary

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ABA ADVERTISING RULE PROPOSAL, CONT'D

compliance, saving significant resources for more serious lawyer misconduct. In most cases where a lawyer is disciplined, it is because the advertising in question was determined to be dishonest, fraudulent, deceitful or a misrepresentation in violation of Rule 8.4(c), or in situations involving coercion, duress, harassment, or intimidation.

And now, the bad news: lawyers facing ethical or malpractice complaints relating to advertising may not have coverage under their legal malpractice policies. As discussed earlier, advertising provides a service…but arguably advertising is not providing professional services to others as required for coverage under many professional liability policies. For example, complaints relating to advertising which incorporates images owned by others in violation of copyright have nothing to do with providing professional services to others, and are not likely to be covered claims despite sometimes significant damages being demanded.

The best way to avoid ethical or malpractice claims relating to advertising is for lawyers to be cognizant of the rules when developing marketing strategies. Do not over-offer and under-deliver, do not embellish experience or predict results, and do not advertise in distasteful or unprofessional ways. Lawyers can use outside specialists to create marketing and advertising plans, but the lawyers must supervise all endeavors to ensure compliance with ethical rules. Some ethics boards will review proposed advertising preemptively to ensure it complies with ethical rules.

Potential Insurance Coverage Implications

In the event that an ethics complaint is lodged or lawsuit filed against a lawyer or law firm for improper advertising, it is possible that the lawyer's professional liability carrier will disclaim coverage on the basis that advertising does not fall within the ambit of providing legal services. If the professional liability carrier denies coverage for an ethics complaint based upon advertising, the lawyer is likely going to have to mount the defense themselves as there is unlikely to be time to have a judicial determination as to coverage before the ethics complaint is adjudicated.

Whether there is merit to the denial on this basis or not, is a point not addressed here, but with regard to a lawsuit, lawyers and their firms may have to look to their CGL coverage and, in particular, the advertising injury coverage to obtain a defense. This would particularly be the case in a situation in which there are a number of claims, or a class of claims, for improper advertising. In order to cover this risk, prior to undertaking advertising efforts, lawyers and their firms should review their policies, both their professional liability and CGL policies, to determine if they have the appropriate coverage and consult with their broker on options. Of course, the best policy is to assiduously follow the rules of professional conduct in the jurisdictions in which the lawyer and law firm practice so as to avoid any claims.

Conclusion

Irrespective of whether the ABA amends the Model Rules or what any state does to amend its rules in response, the basic tenet of professional conduct and good business is to tell the truth to prospective clients. It turns out that with an overlay of some additional rules lawyers are people too and can exercise the right to commercial free speech.

Alice M. Sherren is a Claim Attorney with **Minnesota Lawyers Mutual Insurance Company.** Since joining MLM in 2009 Alice directs the defense of LPL claims and speaks on risk management and ethics matters. Alice may be reached at asherren@mlmins.com.

Donald Patrick Eckler is a partner at **Pretzel & Stouffer,** Chartered, in **Chicago**. Pat defends doctors, lawyers, architects, engineers, appraisers, accountants, mortgage brokers, insurance brokers, surveyors and other professionals. He may be reached at deckler@pretzel-stouffer.com.

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"Do not over-offer and under-deliver, do not embellish experience or predict results, and do not advertise in distasteful or unprofessional ways."

INTRA-FIRM PRIVILEGE FIVE YEARS LATER, BY: PETER L. GREGORY, ESQ. AND UZODIMA FRANKLIN ABA-ONU, ESQ.

It has been nearly five years since the Massachusetts and Georgia supreme courts issued their decisions in *RFF Family Partnership v. Burns & Levinson, LLP*, 991 N.E.2d 1066 (Mass. 2013) and *St. Simon's Waterfront, LLC v. Hunter, Maclean, Exley & Dunn, P.C.*, 746 S.E.2d 98 (Ga. 2013), setting in motion a cascade of state and federal court rulings favoring recognition of intra-firm privilege. This five-year anniversary provides a good opportunity to reflect on how this area of the law has evolved and the current best-practices for preserving intra-firm privilege.

Where We Have Come From

As detailed in a seminal article by PLDF's own Erin Higgins (who was counsel for the law firm in *RFF Family Partnership)*, the decisions in that case and in *St. Simon's Waterfront,* which were issued only a day apart in 2013, represented a significant departure from the majority view in most jurisdictions that communications between a lawyer and a firm's in-house counsel were not privileged. Most courts declined to recognize the intra-firm privilege because of: (1) an attorney's fiduciary duty to his or her client, and (2) the so-called

INTRA-FIRM PRIVILEGE, CONT'D

"current-client" exception. But, the Massachusetts Supreme Judicial Court in *RFF Family Partnership* held that the attorney-client privilege will apply as long as: (1) the firm designates, at least informally, a lawyer or lawyers within the firm to serve as in-house or ethics counsel; (2) where a current outside client threatens litigation, the in-house counsel did not work on the matter in question; (3) the time spent in communication with in-house counsel was not billed to an outside client; and (4) the communications were kept confidential. 991 N.E.2d at 1080-81.

The Georgia Supreme Court in *St. Simon's Waterfront, LLC* reached a similar conclusion on slightly different grounds, holding that an attorney's ethical obligations are "not directly bearing on privilege law" and that intra-firm privilege applies to communications where:

> (1) there is a genuine attorney-client relationship between the firm's lawyers and in-house counsel; (2) the communications in question were intended to advance the firm's interests in limiting exposure to liability rather than the client's interests in obtaining sound legal representation; (3) the communications were conducted and maintained in confidence, and (4) no exception to the privilege applies.

746 S.E.2d at 108.

Jurisdictions Following *RFF Family Partnership* and *St. Simon's Waterfront*

Other jurisdictions have since followed suit, continuing to acknowledge the intra-firm privilege. In *Crimson Trace Corp. v. Davis Wright Tremaine, L.L.P.*, 326 P.3d 1181 (Ore. 2014), the Oregon Supreme Court focused on statutory construction of Oregon's evidence code, which establishes attorney-client privilege in Oregon. *See* Or. Code Evid. 503. The Court concluded that the communications satisfied the required elements for the privilege to attach and that the evidence code did not include a "fiduciary exception." *Crimson Trace Corp.*, 326 P.3d at 1195.

In recent years, courts have continued to affirm intra-firm privilege based on (1) traditional attorney-client privilege (*St. Simon*), (2) the *RFF Family Partnership* four-part test, and (3) statutory construction.

For example, both state and federal district courts in Minnesota have addressed the issue of intra-firm attorney-client communications, endorsing the reasoning in *RFF Family Partnership*. The California Court of Appeals in *Palmer v. Superior Court*, 180 Cal. Rptr. 3d 620 (Cal. Ct. App. 2014) relied on California's evidence code to support the use of the privilege, reasoning that "in California it is well settled that the attorney-client privilege is a legislative creation, which courts have no power to limit by recognizing implied exceptions." *Id.* at 632. And a New Hampshire trial court in *Moore v. Grau*, No. 2013-CV-150 (N.H. Sup. Ct. Dec. 15, 2014) adopted the *St. Simon* test largely on the belief that the *RFF Family Partnership* test is best suited for application "to very large, multi-office firms with full-time general and/or ethics counsel" and that the *St. Simon's* test permitted a more "flexible" approach that is easier to apply to smaller firms.

The most recent court to address intra-firm privilege is the New York Appellate Division Court in *Stock v. Schnader Harrison Segal & Lewis LLP*, 142 A.D.3d 210, 35 N.Y.S.3d 31 (N.Y. App. Div. 2016). In *Stock*, the legal-malpractice plaintiff sought to discover emails from the defendant attorneys to their in-house general counsel. The *Stock* court rejected the fiduciary exception because "for purposes of the in-firm consultation on the ethical issue, the attorneys seeking the general counsel's advice, as well as the firm itself, were the general counsel's 'real clients'." *Id.* at 212, 35 N.Y.S.3d 31. The *Stock* court further reasoned that the communication was privileged because the firm's in-house general counsel's "time spent on the consultation was not billed to plaintiff" and the in-house counsel did not work on "any matter for plaintiff." *Id.* at 222, 35 N.Y.S.3d at 39.

The *Stock* court also declined to adopt the current-client exception, reasoning that the exception should not apply because "the attorney-client relationship had not yet become openly hostile." *Id.* at 235-36, 35 N.Y.S.3d at 49. In supporting its conclusion, the court reiterated that:

> [A]n attorney's or a law firm's duty of loyalty to a client is not always painted in bright lines. It may not always be clear when the interests of the client and the law firm have become so adverse that withdrawal is required in the absence of client waiver, and even when it is clear that withdrawal is necessary, a law firm may need to consider how to minimize the potential adverse consequences of withdrawal to the client, such as where a law firm's withdrawal may imperil a business deal that is near a closing or where a law firm represents the client . . . in multiple legal matters. . . . The in-house counsel whom the law firm has designated to help its attorneys comply with all applicable ethical rules is the logical counsel to turn to for advice as to how the firm may best comply with rule 1.7, especially where time is of the essence. . . . Soliciting . . . advice [concerning a conflict], whether from an in-house coun-

Contact PLDF:
Christine S. Jensen
Managing Director
Professional Liability
Defense Federation
1350 AT&T Tower
901 Marquette Avenue
South
Minneapolis, MN
55402
(612) 481-4169
cjensen@pldf.org

"Other jurisdictions have since followed suit, continuing to acknowledge the intra-firm privilege"

INTRA-FIRM PRIVILEGE, CONT'D

> sel at the law firm or from an attorney at another law firm, is not in and of itself adverse to the client, and doing so may ultimately benefit the client. . . . Ultimately, it is usually in the interests both of the attorney seeking advice and of the client that the ethical issues be examined by a competent advisor who has been fully informed of all relevant facts, with none withheld out of fear that the consultation may not remain private.

Id. at 224, 35 N.Y.S.3d 31, 40-41.

Preserving Intra-Firm Privilege

Depending on your jurisdiction, the intra-firm privilege may be premised on the factors articulated in *RFF Family Partnership* or *St. Simon* or by statutory construction. Regardless, attorneys and firms should proactively adopt the following practices to strengthen their arguments in favor of intra-firm privilege:

1. Each firm should designate a lawyer to serve as the firm's ethics counsel and one other attorney as a backup.
   a. If a current outside client threatens litigation, the in-house counsel must not have worked on the underlying client matter in question.
   b. The ethic's counsel should avoid "ad-hoc deputizing" of additional and previously undesignated attorneys to "assist" with a particular case.
2. Firms should circulate an internal loss-prevention memo advising their attorneys to speak immediately with ethics counsel (and not the client) when a conflict or potential malpractice issue is discovered. The memo should further explain when the attorney's fiduciary duty requires communication with a client regarding a potential malpractice claim.
3. As a practical matter, initial communications regarding a potential conflict or malpractice issue should be conducted in person or by telephone until in-house counsel has had an opportunity to assess the matter and evaluate the applicability of privilege.
4. The client should not be billed for time spent communicating with in-house counsel.
5. Communications with in-house counsel should be kept confidential and shared only to the extent necessary for in-house counsel to advise the firm.

Endnotes

1.Erin K. Higgins, *Are a Lawyer's Communications with the Firm's In-House Counsel Privileged?*, IADC COMMITTEE NEWSLETTER, PROFESSIONAL LIABILITY, Sept. 2013.

2.This exception originated in the context of trust law when a trustee obtained legal advice to guide administration of a trust. *See, e.g., E-Pass Tech., Inc. v. Moses & Singer, LLP*, 2011 WL 3794889 (N.D. Cal. Aug. 26, 2011); *Asset Funding Group, LLC v. Adams & Reese, LLP*, 2008 WL 4948835 (E.D. La. Nov. 17, 2008); *Koen Book Distribs. v. Powell, Trachtman, Logan, Carrle, Bowman & Lombardo, P.C.*, 212 F.R.D. 283 (E.D. Pa. 2002); *In re Sunrise Sec. Litig.*, 130 F.R.D. 560, 595 (E.D. Pa. 1989). Under these circumstances, the attorney-client privilege would not apply when a beneficiary seeks to discover communications related to the advice because the beneficiary is the attorney's client, not the trustee.

3. *See JJ Holand, Ltd. v. Fredrikson & Byron, P.A.*, Civ. No. 12-3064 ADM/TML (D. Minn. July 17, 2014) and *Coloplast A/S and Coloplast Corp., v. Spell Pless Sauro, P.C.*, Civ. No. 27-CV-12-12601, 2013 Minn. Dist. LEXIS 45 (Minn. Dist. Ct. Nov. 22, 2013).

4. *See Leonard v. Dorsey & Whitney L.L.P.*, 553 F.3d 609, 629 (8th Cir. 2009) (stating that the Minnesota Supreme Court "would not hold a lawyer liable for failure to disclose a possible malpractice claim unless the potential claim creates a conflict of interest that would disqualify the lawyer from representing the client.")

Peter Gregory is a shareholder at the Minneapolis law firm of Bassford Remele, P.A., where he focuses his civil litigation practice on defending and counseling professionals, including lawyers and medical providers. He may be reached at pgregory@bassford.com.

Uzodima Franklin Aba-Onu is an associate at the Minneapolis law firm of Bassford Remele, P.A. Frank practices in all areas of civil litigation, with a focus on professional liability, general liability, and employment law. Frank is also an adjunct professor at Mitchell Hamline School of Law. He may be reached at fabaonu@bassford.com.

> "Each firm should designate a lawyer to serve as the firm's ethics counsel and one other attorney as a backup."

PLDF Amicus Program

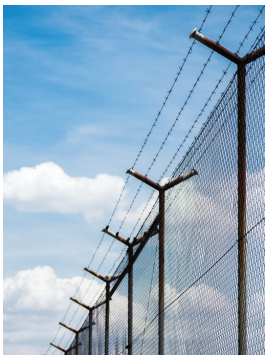
Please let us know of appeals in your jurisdictions implicating important professional liability issues that might have national significance.

CORRECTIONAL SETTING HEALTH CARE: VARIANT STANDARDS OF CARE?, BY: MARK V. GENDE, ESQ. AND JOHN E. TYLER, ESQ.

For healthcare professionals, failure to understand the standard of care under which they provide services may result in significant financial liability and jeopardize their license to practice. In the correctional care setting a unique opportunity exists for confusion regarding the standard of care that applies to doctors, nurses, dentists, and other healthcare professionals providing care within the prison, jail, or detention facility settling. This confusion arises when the correctional health care provider has an incomplete understanding of the deliberate indifference standard applicable to federal Section 1983 civil rights claims brought by prisoners and the reasonable care standard applicable state medical negligence claims. This article is intended to explain what the deliberate indifference standard is and its relationship – or lack thereof -- to the reasonable care standard of a state medical negligence claim.

Based on the sheer volume of lawsuits filed by inmates in the federal system, professional liability defense counsel, especially those who practice in the area of medical liability, have an significant chance of being referred a Section 1983 prisoner petition at some point during their career. According to the United States Courts' reporting of Federal Judicial Caseload Statistics for the 2016 reporting year, approximately 275,000 civil actions were filed. Prisoner petitions accounted for just under twenty percent or 54,000 of those action. (http://www.uscourts.gov/statistics/table/c-2/federal-judicial-caseload-statistics/2016/03/31.) With such a significant amount of the federal docket being consumed by inmate cases, and with the trend for government entities to contract out correctional duties to the private sector, it is vital for all professional liability litigators who practice in the medical filed to fully understand the differences between the Section 1983 deliberate indifference claim standard and the medical negligence reasonable care standard.

While correctional healthcare providers understand that when they or their counterparts practice in the civil population, they are held to the standard of reasonable care, within the walls of the correctional facility, confusion may exist about what standard applies when providing healthcare screenings, responding to inmates requests for care, or providing general medical services in the detention facility. There is a common misunderstanding that the standard of care is lowered within the prison from a standard of reasonable care to a standard of deliberate indifference. This is a serious error that can have catastrophic consequences for both the detainee and the medical provider, and is gravely serious for two reasons. First, it is legally incorrect and does not reflect a proper understanding of how the deliberate indifference standard and the reasonable care standard relate, which is the scope of this article. Second, it is dangerous, because when the healthcare provider thinks they do not have to provide the same level of care as a civilian provider, he or she may be tempted to ignore or incompletely address the medical needs of inmates, potentially resulting in serious medical injury or even death, and the related legal and professional liability.



Legal Options Available to Inmates and Detainees against Healthcare Providers

An inmate or detainee who believes they have not been provided appropriate medical care may choose to file one or more actions against the correctional healthcare provider. The prisoner's choices depend in part on the type of facility in which the inmate is confined. State prisoners may file what are called Section 1983 Claims (the right to bring a claim in federal court for the violation of a constitutional right) or state court claims for medical negligence. Federal prisoners may file similar claims against the federal government under the Federal Tort Claims Act for torts or through *Bivens* Actions for constitutional claims. When a medical provider is sued by an inmate in state court for state medical negligence claims, the reasonable care standard applies when evaluating the merits of the claim. However, when a medical provider is sued by an inmate in federal court under 42 U.S.C. §1983 (a Section 1983 claim) for the violation of prisoner's constitutional rights, specifically the right under the Eighth Amendment of the United States Constitution to be free from cruel and unusual punishment, a different standard applies in evaluating the merits of the claim—the deliberate indifference standard.

> "An inmate or detainee who believes they have not been provided appropriate … care may choose to file one or more actions against the correctional healthcare provider."

What is The Deliberate Indifference Standard?

The seminal case that established prisoner claims for deliberate indifference is *Estelle v. Gamble*, 429 U.S. 97, 97 S. Ct. 285, 50 L. Ed. 2d 251 (1976). In *Estelle*, the United States Supreme Court considered the case of a Texas inmate who suffered a back injury when a bale of cotton fell on him during work detail. He developed persistent and debilitating back pain. The inmate was seen and treated by prison medical staff on seventeen different occasions over a number of months, but in his handwritten complaint alleged that more should have been done to diagnose and treat his condition. Because more was not done, the inmate contended he was subjected to cruel and unusual punishment. The Court held that the failure to do more to diagnose and teat the inmate, such as securing an x-ray, may have been actionable as medical negligence under a state court claim, did not raise to the level of deliberate indifference to a serious medical need in violation of the inmate's civil protection from cruel and unusual punishment under the Eighth Amendment of the United States Constitution. Therefore, a claim for medical deliberate indifference claim under § 1983 is not strictly speaking a medical negligence claim, although it

CORRECTIONAL SETTING HEALTH CARE, CONT'D

arises in the medical treatment context. Rather, a Section 1983 deliberate indifference claim is a claim for deprivation of civil rights under the United States Constitution, specifically the right to be free from cruel and unusual punishment. The Supreme Court explained "deliberate indifference to serious medical needs of prisoners constitutes the 'unnecessary and wanton infliction of pain,'" and is therefore a violation of the prisoner's Eighth Amendment rights. *Estelle* at 104, 97 S. Ct. at 291, 50 L. Ed. 2d at 251.

The Elements of a Deliberate Indifference Claim

As announced in *Estelle*, the elements of a § 1983 deliberate indifference medical claim are that (1) a prison official is (2) deliberately indifferent to (3) an inmate's serious medical need (4) resulting in harm or injury. Each elements are required in order for an inmate to prevail in his or her action.

The prison official element is satisfied when one is a government actor or acts under the color of state law. In the correctional health care setting, a physician, nurse, dentist, med tech, or other health care provider who is either employed by the government entity or employed by a private company operating under contract with the government entity to provide care and treatment for inmates of a correctional facility is generally considered a prison official. *West v. Atkins*, 487 U.S. 42, 108 S. Ct. 2250, 101 L. Ed. 2d 40 (U.S. 1988). However the definition of prison official in a Section 1983 medical claim is not limited to medical staff. A prison official may also be any correctional officer, sheriff, warden or jail employee who becomes aware of an inmate's serious medical needs and ignores them.

The deliberate indifference element is satisfied when a government actor is deliberately indifferent to an inmate's serious medical need. The Section 1983 claim is a claim regarding the deprivation of the inmate's civil right under the United States Constitution to be free from cruel and unusual punishment, not simply a claim that the inmate did not receive proper medical care, which is the gravamen of a state medical negligence claim. Thus, the deliberate indifference claim poses the question of whether the inmate was cruelly and unusually punished in his or her conditions of confinement. With respect to correctional healthcare providers the context of the claim implicates the medical care and treatment associated with the detainee or inmate's confinement. Whether of a medical nature or another condition of confinement. Deliberate indifference is further explained in *Farmer v. Brennan*, 511 U.S. 825, 114 S. Ct. 1970, 128 L.Ed.2d 811 (1994). The Court instructs in *Farmer* that "a prison official cannot be found liable… unless the official knows of and disregards an excessive risk to inmate health or safety." The Court further clarifies that the deliberate indifference standard requires the official to be "both aware of facts from which the inference could be drawn that a substantial risk of serious harm exists, and he must also draw the inference." Thus, it is a subjective standard based on the defendant's actual knowledge at the time of the incident. In the medical setting, a plaintiff must prove that a correctional care professional knew of the plaintiff's serious medical need and deliberately and intentionally ignored the need. The Supreme Court held in *Estelle* that mere medical negligence does not constitute a claim for deliberate indifference to a serious medical need. Additionally, different Circuits have explained that disagreements between an inmate and medical provider as to the type of treatment provided do not constitute deliberate indifference.

It is not enough, however, for the plaintiff to establish that the correctional care provider was deliberately indifferent to *any* medical need. The need must be a *serious* medical need—the third element of a Section 1983 claim. Multiple Circuit Courts of Appeal have adopted the standard that a medical need may be deemed objectively serious if it is "one that has been diagnosed by a physician as mandating treatment or one that is so obvious that even a lay person would easily recognize the necessity for a doctor's attention." *Ramos v. Lamm*, 639 F.2d 559 (10th Cir. 1980); *Webb v. Driver*, 313 F. App'x 591 (4th Cir. 2008). Knowledge of the serious medical need will be inferred, however, if the condition is obvious. *Farmer v. Brennan*, 511 U.S. 825, 842 (1995).

Even though it is an objective standard, what constitutes a serious medical need is a moving target that varies from case to case. The following are examples of circumstances that courts have recognized as rising to the level of a serious medical need:

- During a period of three weeks, an inmate complained daily of pain and swelling in his side, but no treatment was provided. Due to the pain, the inmate passed out, was transported to the hospital, and ultimately his gallbladder was removed because of gallstones. *Toombs v. Bell,* 915 F.2d 345, 347 (8th Cir. 1990).
- An inmate alleged that he complained of a hernia, he needed surgery, and that the prison officials failed to schedule his medically necessary hernia surgery. The inmate provided documentation showing that the surgery had been recommended by multiple physicians prior to his incarceration, with one surgeon noting it was "required." *Webb v. Driver*.
- A double-amputee inmate suffering from MRSA was placed in segregation, but was not provided assistance with "daily dressing changes for the actively-draining infected stump of her leg." *Stoudemire v. Michigan Dep't of Corr*., 22 F. Supp. 3d 715, 718 (E.D. Mich. 2014), *aff'd,* 614 F. App'x 798 (6th Cir. 2015).

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"Even though it is an objective standard, what constitutes a serious medical need is a moving target that varies from case to case."

CORRECTIONAL SETTING HEALTH CARE, CONT'D

- An inmate's ear was severed, the physician disposed of the ear in the inmate's presence and instructed him that his ear was not necessary. *Williams v. Vincent*, 508 F.2d 541, 544 (2d Cir. 1974).

Inmates frequently, however, bring Section 1983 Claims that do not rise to the level of deliberate indifference to a serious medical need. The following list contains examples of § 1983 deliberate indifference actions filed in the Federal District Court, all of which resulted in the court granting defendants' motions for summary judgment, partly because the plaintiff did not establish the serious medical need element: an inmate wanted a particular medication to treat the symptoms of multiple sclerosis, but provider was able to provide an alternative; an inmate demanded a gluten free diet; an inmate requested to have teeth whitened by dentist so that he would appear presentable for a court hearing; an inmate consistently requested a rectal exam, received the rectal exam, then sued for cruel and unusual punishment of a sexual nature; an inmate wanted a particular medication for deep vein thrombosis, but provider was able to provide an alternative; an inmate wanted narcotic pain medication consistent with his medication regimen prior to incarceration; and an inmate had dry skin and wanted care and treatment other than lotion or ointment.

Additionally, the United States Supreme Court held in *Estelle* that mere medical negligence alone does not constitute a claim for deliberate indifference to a serious medical need. *Estelle* at 105–06, 97 S. Ct. at 292, 50 L. Ed. 2d at 251. This is a simple statement distinguishing between a medical negligence claim and the deliberate indifference element of a Section 1983 claim for the violation of an inmates civil rights.

However, correctional health professional and professional liability attorneys who represent them must understand that deliberate indifference is not a separate standard for medical providers in a correctional setting, but that deliberate indifference is merely an element in a civil rights claim that is wholly separate from a state medical negligence claim. Therefore, deliberate indifference is not a lower standard of care for prisoners than the reasonable care standard is for civilians.

How the Reasonable Care Standard Relates to the Deliberate Indifference Standard

How does the deliberate indifference standard (or more properly understood as an element of a Section 1983 claim for deprivation of Constitutional rights) relate to the healthcare providers standard of reasonable care?

All health care providers are held at all times to the standard of reasonable care in performance of their professional services. *Dawkins v. Union Hosp. Dist.*, 408 S.C. 171, 178, 758 S.E.2d 501, 504 (2014) (South Carolina state case law cited here, the writers' jurisdiction of practice, contains typical statements of the standard of reasonable care applicable to medical professionals). Reasonable care is defined as "that degree of care and skill which is ordinarily employed by the profession generally, under similar conditions and in like surrounding circumstances." *Welch v. Whitaker*, 282 S.C. 251, 258, 317 S.E.2d 758, 763 (Ct. App. 1984) (quoting 61 Am.Jur.2d *Physicians, Surgeons, and Other Healers* § 205 at 337-38 (1981)). The standard of care for health care providers considers the care and skill of competent physicians nationally rather than those in similar localities. *King v. Williams*, 276 S.C. 478, 482, 279 S.E.2d 618, 620 (1981).

While Section 1983 medical claims and professional negligence claims both involve allegations regarding medical care, the correctional healthcare provider and their attorneys need to have a clear understanding of the relationship between the state medical malpractice reasonable care standard versus the Section 1983 civil rights claim deliberate indifference standard.

First, deliberate indifference is not a substitute standard of care for correctional healthcare as opposed to civilian healthcare. Both the correctional healthcare professional and the civilian healthcare professional are always under the standard of reasonable care whether treating patients inside or outside of the prison population.

Second, deliberate indifference is not a lower standard of care for practice within jails or detention facilities. An improperly educated medical professional within the correctional healthcare setting may reason that because he or she is dealing with detainees or inmates their only obligation is not to be deliberately indifferent to a serious medical need. Instead, the correctional healthcare professional is always under the obligation to provide medical care in conformity to the standard of reasonable care under the circumstances of each inmate's presentation.

Third, deliberate Indifference, properly understood, is not a standard of care for medical treatment at all. The deliberate indifference "standard" is actually an "element" of a civil rights claim for violation of an inmate's Eighth Amendment constitutional protection to be free from cruel and unusual punishment. For healthcare professionals within government correctional facilities, Section 1983 claims arise within the administration of medical care.

"Therefore, deliberate indifference is not a lower standard of care for prisoners than the reasonable care standard for civilians."

CORRECTIONAL SETTING HEALTH CARE, CONT'D

Conclusion

There are not two standards of care for a correctional care professional. The standard of reasonable care *always applies* to any medical professional in the healthcare field, whether the care is being provided in a civilian or a correctional setting. The correctional healthcare professional may be easily confused by the technical legal distinctions between the term "deliberate indifference standard" used as short-hand to describe Section 1983 claims and the term "reasonable care standard" which is the accurate description of the standard of care for *all* healthcare providers. However, what is crucial for the correctional healthcare attorney and provider to understand is that the deliberate indifference standard is not a substitute or lower standard of care applied to healthcare providers in the correctional care settling. Instead, the deliberate indifference standard is simply one element of a Section 1983 Claim as opposed to a state medical negligence claim. Section 1983 and state medical claims are two entirely different legal claims. Correctional healthcare providers, like all healthcare providers, must provide care that is reasonable under the circumstances to all inmates.

Mark V. Gende is a partner with Sweeny, **Wingate & Barrow**, PA in **Columbia, South Carolina**; he is also a board member of PLDF. Mark practices in medical, nursing home, assisted living, and correctional healthcare defense. He may be reached at mvg@swblaw.com.

John E. Tyler is a senior associate with **Sweeny, Wingate & Barrow**, PA in **Columbia, South Carolina**. John practices in correctional healthcare defense and appellate work, as well as a number of insurance defense disciplines. He may be reached at jet@swblaw.com.

CYBERSECURITY PII BREACH: STATE LAW SURVEY, BY: JANUARY D. ALLEN, ESQ.

Your client or insured has experienced a cybersecurity breach that potentially compromises the security, confidentiality, or integrity of personal information. Among the initial critical steps following discovery is determination of legal responsibilities regarding notification and reporting. However, in the absence of a uniform federal law governing cybersecurity breaches involving personally identifying information, this is not a simple task. In addition to federal reporting requirements, or requirements specific to public entities (both of which are beyond the scope of this article), 48 states, plus the District of Columbia, and three U.S. territories currently have their own breach notification laws for cyber security breaches involving "personal information." Compliance efforts are complicated by variance between these laws in triggering events, persons to whom notification or disclosure is to be provided, and the timing and content of notifications.

This article surveys state notification laws concerning cybersecurity breaches involving personal information. It provides a general breakdown of the components of notification requirements, and highlights some critical discrepancies. These state laws are evolving rapidly, with a plethora of introduced and pending legislation. A helpful resource with citations to each cybersecurity notification law, as well as information on pending legislation, is The National Conference of State Legislatures. This survey is not intended to constitute legal advice, and should not be used in lieu of a careful review of the statutory language governing specific claims.

What Kind of Information Breach Triggers State Reporting Statutes?

State notification laws cover breaches involving "personal information." These laws typically define with more specificity than the Government Accountability Office's definition of Personally Identifiable Information ("PII"). For most states, "personal information" encompasses data that includes: a person's last name and first initial (or first name) plus one of the following: (a) Social Security Number, (b) a government issued ID number, or (c) account number combined with access information. New York defines this combination as 'private information' rather than 'personal information.' Exclusions for publicly available information are typical in state definitions of personal or private information.

However, the definition of "personal information" varies by state, with some statutes providing broader definitions or very specific examples. Some states are triggered simply by a breach involving singular components of, rather than full sets or combinations of, the information noted above. For example, Alaska requires notification if just the financial institution PINs or passwords are affected, without the need for combination with the account numbers. *A.S. 45.48.090*. Massachusetts protects the account numbers alone, without the need for a breach involving the PINs or access information. *Mass. Gen. Laws, Title XV, Ch. 93h, Section 1(a)*. California protects usernames plus passwords, or security questions for 'online accounts.' *Cal. Civ. Code 1798.81.5(d)(1)*. New Jersey has a broad catch-all, covering, "dissociated

"Exclusions for publicly available information are typical in state definitions of personal or private information."

CYBERSECURITY PII BREACH, CONT'D

data, that, if linked, would constitute personal information is personal information if the means to link the dissociated data were accessed in connection with access to the dissociated data." *N.J. Rev. Stat. § 56:8-161*. Biometric data is becoming more commonly incorporated, and is currently protected by states including Iowa, Connecticut, Nebraska, and Delaware. Health information, insurance information, and student information are also commonly protected. A safe harbor for encrypted data is common, unless the encryption key has also been compromised. However, some states are beginning to limit the application of this safe harbor in order to more fully protect their residents. Given the foregoing variances and changes in encryption safe harbors, careful review of applicable state statutes is essential even if the cybersecurity event involved only discrete components of data that, standing alone, are unlikely to lead to a risk of identity theft or fraud.

What Constitutes a Triggering Breach?

Unauthorized Access v. Unauthorized Acquisition

If the cybersecurity event involves "personal information," the next step is to determine whether the event is a "breach" triggering state reporting and notification laws. For some, *access* to the personal information, without a showing that it was also acquired, constitutes a "breach." For four states/territories, North Dakota, Connecticut, New Jersey, and Puerto Rico, notification requirements can be triggered merely by *unauthorized access*. Puerto Rico's law, for example, is triggered by unauthorized access, where the intrusion can be physical or electronic. *10 L.P.R.A. § 4051*. North Dakota and Connecticut reference unauthorized access *or* acquisition. *See, e.g., Conn. Gen. Stat. §36a-701b*. While some states, like New Jersey, limit breach to an unauthorized access that "compromises the security, confidentiality or integrity" of the data, where such compromise is undefined, arguably any unauthorized access could be a triggering event. *See N.J. Rev. Stat. § 56:8-161*.

Perhaps in recognition of potential complications arising from a lower threshold, the remainder of states and territories with notification laws require unauthorized *acquisition* of the protected information to constitute a breach. New York's statute defines a breach as an "unauthorized acquisition" that "compromises the security, confidentiality or integrity" of the personal information. *N.Y. Gen. Bus. Law § 899-aa(c)*. Other states use largely analogous (if not identical) language. New York, perhaps uniquely, provides criterion to assist in the determination of whether "unauthorized access" has occurred. However, the parameters of an event that "compromise[s] the security, confidentiality or integrity" are largely undefined by any state statute. As any "unauthorized acquisition" event could arguably compromise the data's security, the "compromise" language seems superfluous.

For 12 states/territories a triggering "breach" exists solely on the basis of "unauthorized access" or "unauthorized acquisition," discussed above. These are as follows: California, Georgia, Illinois, Minnesota, Nebraska, Nevada, New York, North Dakota, Tennessee, Texas, Puerto Rico, and the U.S. Virgin Islands. For the remainder, a breach triggering notification requirement does not occur absent an indication of harm to residents.

Risk of Harm Analysis

Whether breach constitutes access or acquisition, the majority of states also require that there be some finding of potential harm to residents before notification requirements are triggered. This 'risk of harm' analysis is to be carried out by the client/insured following its discovery of the breach. Statutes generally require that the risk of harm investigation be reasonable and prompt, but most do not provide additional parameters. Guidance beyond 'reasonable' or 'good faith belief' regarding risk of harm after such investigation is rare. However, some states, including Alaska, Connecticut, and Florida, require that the determination be made only after consultation with or notification to law enforcement or state government or agency. Some states like Oregon and New Jersey require that written documentation of such investigations be undertaken and maintained for at least five years thereafter.

> "Whether breach constitutes access or acquisition, the majority of states also require that there be some finding of potential harm to residents … ."

Statutes also differ on the degree of harm or potential harm triggering notification requirements. Many, like Louisiana, generically state that that the investigation is to conclude "there is no reasonable likelihood of harm to consumers." *La. Rev. Stat. Ann. § 51:3074*. Arizona defines its harm threshold as a breach involving personal information that also, "causes or is reasonably likely to cause substantial economic loss to a resident." *Ariz. Rev. Stat. Ann § 18-545*. Ohio's criterion is whether there is a reasonable belief that the breach has or will cause "a material risk of identity theft or other fraud…" *Ohio Rev. Code Ann. § 1349.19*. Massachusetts heightens the trigger threshold by stating that the risk of harm must be 'substantial.' *201 C.M.R. 17.01*. Vermont, in contrast, lowers the threshold. It requires that the investigation conclude that there is "no reasonable possibility of misuse of the information." *Vt. Stat. Ann. Tit. 9, §§ 2430, 2435*. Other states treat the risk of harm analysis as an exception unavailable to certain entities. Maine only applies its additional harm threshold component for entities that are not "information brokers." *Me. Rev. Stat. tit. 10 §§ 1348*.

CYBERSECURITY PII BREACH, CONT'D

When it Becomes a Government Affair

An increasing number of states are requiring notification not only to consumers, but also disclosure to law enforcement or government agency. Some states require disclosure to government agencies of events affecting a stated number of their residents. For North Dakota, this threshold is a breach affecting 250 or more. For Hawai'i, it is 1000 or more. For Iowa, it is 500 or more. Other states only require government notification if the affected entity is of a certain type. Idaho requires government disclosure for breaches affecting public entities. Ohio requires disclosure by insurance carriers experiencing a breach. However, there are states that have implemented strict government disclosure requirements for every breach affecting personal information of residents. These include Alaska, Connecticut, Indiana, Louisiana, Maryland, Massachusetts, Montana, Nebraska, New Hampshire, New Jersey, New York, North Carolina, Vermont, and Virginia.

For those states requiring government disclosure, there is also variance in the timing, contents, and consequences. Some set forth requirements for the timing of disclosure to the government. States including Maryland and New Jersey actually require that the attorney general's Office be notified *prior* to notice to affected residents. Iowa provides a window of only five days to notify the consumer protection division of its attorney general's office from discovery of a breach affecting 500 or more residents. *Iowa Code § 715C.2 (8)*. Other states, like Massachusetts, require disclosure to multiple government agencies. *Mass. Gen. Laws § 93H-1 et seq.* Puerto Rico's requirements also have significant public relations implications for breach responses. Puerto Rico not only requires mandatory notification to its Department of Consumer Affairs within 10 days of discovery, but the Department then makes a public announcement of this fact 24 hours thereafter. *10 L.P.R.A. § 4052*. Vermont's government will also make a public disclosure of the breach. *Vt. Stat. Ann. Tit. 9, §§ 2430, 2435*.

Many states, even those that do not have government disclosure obligations, require the affected entity to notify the major consumer reporting agencies if the breach affects a certain number of residents. These include Colorado, Florida, Georgia, Hawai'i, Kansas, Maine, Maryland, Michigan, Minnesota, Missouri, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Ohio, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Texas, West Virginia, and D.C. While 1,000 affected persons is the most common denominator triggering such notification, it varies from a few hundred (North Dakota) up to 10,000 (Texas' reporting criteria).

Timing is Key

State notification statutes typically require that notice be provided to affected consumers promptly or without unreasonable delay. Some states go further and set forth very specific time tables, often with very short deadlines. Specific deadlines applicable to medical or health information are beyond the scope of this article. When timelines for notification are imposed for personal information breaches, they range from 30 days (Florida) to 90 days (Connecticut) following discovery of the breach. The most common denominator is a 45 day deadline from discovery. There are some instances in which a disclosure to a government agency, as discussed above, has a shorter timetable than notifications to affected residents. Notably, Vermont requires disclosure of the breach to its Attorney General within 14 days of discovery, or notification to consumers, whichever is sooner. *Vt. Stat. Ann. Tit. 9, Ch. 62, § 2435*. Puerto Rico sets the shortest fuse, requiring government disclosure within 10 days of discovery. *10 L.P.R.A. § 4052*.

It is likely that states will increasingly seek to implement tighter timetables, given recent criticisms of both the 2016 Uber breach, which went undisclosed until late 2017, and Equifax's failure to report its breach until 41 days after discovery. These types of large scale breaches, combined with delayed reporting, may ultimately be the impetus for successful passage of federal law as well. In November 2017, the Data Security and Breach Notification Act was introduced in the Senate. If passed, this Act will require reporting of data breaches within 30 days, and impose criminal penalties for concealment.

Contents of Notification

The majority of statutes require written or electronic notice, with the latter being subject to exceptions. Substitute notice is generally allowed only in very limited circumstances. Only a few states have outlined content requirements for the notice, and generally provide only limited general information. For example, New York states that the notice is to provide contact information for the entity sending the notice, and a description of the categories of affected information. *N.Y. Gen. Bus. Law § 899(7).* By contrast, California has highly specific content requirements in its statute, and even provides a recommended form for the notice. *Cal. Civ. Code §1798.82*.

Penalties and Ramifications

Compliance with notification requirements cannot be disregarded, and some states have implemented penalties for violations. Florida's statute carries some of the stiffest penalties. Failure to provide notification to affected residents within 30 days of the breach can result in fines of $1,000 per day for the first thirty days, then, up to $50,000 for each successive thirty day peri-

"Compliance with notification requirements cannot be disregarded, and some states have implemented penalties for violations."

CYBERSECURITY PII BREACH, CONT'D

od up to 180 days, after which penalties may accrue to an amount not to exceed $500,000 if the violation continues. *Fla. Stat., Title 33, Ch. 501, §501.171*. In addition to enforcement by the state government, a private cause of action is afforded to a state resident affected by a breach of the notification statutes in the 17 states or territories. A majority of laws allowing for citizen claims, including Tennessee's, tie the action back to the state's deceptive or unfair trade practices statute. Some also allow for the recovery of attorney's fees and costs. Accordingly, entities affected by breach could not only face regulatory penalties for failure to comply with notification laws, but also have exposure in lawsuits for damages resulting to state residents from a failure to notify or untimely notification.

Closing Recommendations

In conclusion, once a cybersecurity event potentially affecting any component of "personal information" has been discovered, the company must work promptly with its forensic team to determine the nature of the event, the type of data affected, and identification of the persons affected including the states in which they reside. This information can then be used in the company's consultation with its legal counsel to determine legal responsibilities, including those under state notification laws discussed in this article. The laws of affected states should be closely examined to determine if the event constitutes a "breach." The most stringent requirements find that a "breach" has occurred if there is "unauthorized access" to components of PII. If the event constitutes a "breach" in any of the affected states, consideration should then be given to government disclosure requirements as there are states that provide very short deadlines. The next step in the event of a breach would be determining if the laws of the affected states require notification to residents. The most stringent laws require notification for any breach, while others are triggered by the number of residents affected or the risk of harm. In order to comply with the shortest potentially applicable deadlines, the company should, within 30 days, work with its public relations and legal teams to arrive at the appropriate timing, content and manner of notifications.

January D. Allen is a partner at the law firm of **Overturf McGath & Hull,** P.C. in **Denver, Colorado**. Her practice focuses on the defense of licensed professionals, commercial litigation, and intellectual property matters. She can be reached at jda@omhlaw.com.

EMPLOYEE NON-DISCLOSURE AGREEMENTS POST-WEINSTEIN AND #METOO, BY: ROBERT G. CHADWICK, JR., ESQ

In the wake of the sexual harassment allegations against Harvey Weinstein and the ensuing #MeToo movement, employee non-disclosure and non-disparagement agreements have been vilified by the press, politicians and #MeToo victims. Never before have such agreements been under more scrutiny.

Such agreements rocketed to public attention in a New York Times article published on October 5, 2017. According to the article, employees of the Weinstein Company have agreements not to harm the company's "business reputation" or "any employee's personal reputation." Employees who settled claims of sexual harassment against the company and its co-founder, Harvey Weinstein, also signed agreements requiring they keep the claims and settlement confidential. For years, these agreements kept the substance and number of sexual harassment allegations against Mr. Weinstein secret.

The effectiveness of the Weinstein Company agreements in concealing alleged harassment raised key questions. Do such agreements enable future harassment by eliminating publicity as a deterrent? Are such agreements legal? Do such agreements violate public policy? Should such agreements be illegal or restricted?

It is not surprising these questions are already being answered by politicians at both the federal and state level. Indeed, a new federal law has already been passed as to any settlement or payment related to sexual harassment that is subject to a non-disclosure agreement. It is also likely these questions will soon be addressed in litigation.

The Cross Hairs of the Controversy

Restrictive agreements between employees and private employers are not unusual. Non-disclosure agreements can provide protections for an employer's trade secrets and proprietary data not otherwise provided by the Defend Trade Secrets Act of 2016 or state trade secrets law. The agreements can encompass sensitive data entrusted to an employer by a customer, vendor or employee, thereby mitigating the risk of legal exposure for breach of such confidences. Non-disparagement agreements can provide safeguards to an employer's reputation not otherwise provided by state defamation or breach of fidu-

"The effectiveness of the Weinstein Company agreements in concealing alleged harassment raised key questions."

EMPLOYEE AGREEMENTS POST-WEINSTEIN AND #ME TOO, CONT'D

ciary duty laws.

Non-disclosure agreements can also be a condition precedent, in addition to a release of claims, to (1) payment of severance to a departing employee, or (2) payment as to a disputed claim by a current or former employee. Often, the pledge of confidentiality extends not just to the existence or terms of a severance or settlement agreement, but also to claims extinguished by the agreement. For many employers, such confidentiality has more value than a release of claims. Without a pledge of confidentiality, the employer may opt to pay less or nothing at all for a release of claims.

To be sure, not all restrictive agreements purport to encompass sexual harassment claims. Still, some agreements have, as an intended objective, the silence of alleged harassment victims. Other agreements are drafted so broadly that they, intentionally or unintentionally, act as a deterrent to open discussion of harassment. These are the agreements at the cross hairs of the current controversy.

Tax and Job Cuts Act

The first governmental action with respect to non-disclosure agreements went largely unnoticed until recently. As part of the Tax and Job Cuts Act signed by President Trump on December 22, 2017, Section 162 of the Internal Revenue Code has been amended. Section 162 generally allows for "a deduction [of] all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business."

Section 162(q), however, provides a new exception to this deduction allowance. Section 162(q) states "[n]o deduction shall be allowed for (1) any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement, or (2) attorney's fees related to such a settlement or payment."

Fair Labor Standards Act

Federal circuit courts are split whether a private settlement agreement can release a wage claim under the Fair Labor Standards Act ("FLSA") without district court approval or Department of Labor ("DOL") supervision. *Contrast Lynn's Food Stores, Inc. v. United States Dep't of Labor,* 679 F.2d 1350, 1355 (11th Cir.1982)(district court approval or DOL supervision required) *with Martin v. Spring Break '83 Prods., L.L.C.,* 688 F.3d 247, 253–57 (5th Cir.2012) ("[A] private compromise of claims under the FLSA is permissible where there exists a bona fide dispute as to liability"). Courts in circuits which take a restrictive approach to FLSA settlements have said "[c]onfidentiality provisions in FLSA settlements are contrary to public policy." *See Souza v. 65 St. Marks Bistro*, No. 15 Civ. 372, 2015 WL 7271747 at *4 (S.D.N.Y. Nov. 6, 2015).

A private severance or settlement agreement which releases FLSA claims may thus not necessarily safeguard an employer from subsequent suit or disclosure of confidences. These gaps may prove significant in the future as to agreements that also encompass harassment claims.

National Labor Relations Act

The National Labor Relations Act ("NLRA") protects "concerted activities … for mutual aid or protection" by non-supervisory employees; protected speech includes communications by employees about terms and conditions of employment with one another and third parties. The National Labor Relations Board ("NLRB") has confirmed this protection includes discussion of sexual harassment. *See Fresh & Easy Neighborhood Market*, 361 NLRB No. 12 (2014)

In *The Boeing Co*., 365 NLRB No. 154 (2017), the NLRB recently changed the way it views facially neutral agreements. Under both the old and new standard, however, a non-disclosure or non-disparagement agreement can be an unfair labor practice under the NLRA, even in the absence of enforcement, if it unlawfully interferes with protected speech.

On March 24, 2017, the D.C. Circuit, in *Banner Health System v. NLRB,* 851 F.3d 535 (D.C. Cir. 2017), for instance, found an employer's Confidentiality Agreement to be an unfair labor practice because it explicitly directed employees not to discuss co-workers "[p]rivate employee information." On July 29, 2016, in *Quicken Loans, Inc. v. NLRB*, 830 F.3d 542 (D.C. Cir. 2016, the D.C. Circuit held that a non-disparagement rule in an employment agreement constituted an unfair labor practice where it stated: "You agree that you will not (nor will you cause or cooperate with others to) publicly criticize, ridicule, disparage or defame the Company or its products, services, policies, directors, officers, shareholders, or employees …"

Overly broad settlement agreements with employees can also run afoul of the NLRA. In *Metro Networks*, 336 NLRB No. 3 (2001), the NLRB held that an employee severance agreement prohibiting voluntary assistance to other employees with claims arising under the Act was unlawful.

For employers that require non-supervisory employees to sign overly broad non-disclosure or non-disparagement agreements as a condition of employment, therefore, unfair labor practice charges are already a risk. This risk may now be amplified as non-supervisory employees see the NLRB as an avenue for challenging agreements that chill discussions of harassment.

Federal Employment Discrimination Laws

Federal courts have consistently held that individuals have a non-waivable right to (1) file charges of discrimination with the Equal Employment Opportunity Commission ("EEOC") or comparable state or local agencies,

> "Without a pledge of confidentiality, the employer may opt to pay less or nothing at all for a release of claims."

EMPLOYEE AGREEMENTS POST-WEINSTEIN AND #ME TOO, CONT'D

and (2) assist such agencies in the investigation of claims of discrimination against an employer. *See EEOC v. Astra USA, Inc.*, 94 F.3d, 738, 742 (1st Cir. 1996); *EEOC v. Cosmair, Inc.*, 821 F.2d 1085, 1089 (5th Cir.1987). In fact, in its Strategic Enforcement Plan FY2013-2016, the EEOC announced a strategy of targeting "overly broad waivers" and "settlement positions that prohibit filing charges with the EEOC or providing information to assist in the investigation or prosecution of claims of unlawful discrimination."

In 2013, the EEOC sued Baker & Taylor, Inc. (*EEOC v. Baker & Taylor, Inc.*, Civil Action No. 1303729 (N.D.Ill. 2013), alleging the company's severance agreement unlawfully interfered with employees' rights to file charges. The focus of the complaint were provisions in which the employees agreed to (1) "never to institute any complaint … in any administrative agency of the United States", (2) "not make any disparaging remarks or take any other action that could reasonably be anticipated to damage the reputation and goodwill of Company or negatively reflect on Company", and (3) "not discuss or comment upon the termination of my employment in any way that would reflect negatively on the Company." Baker & Taylor promptly settled the suit.

Even before 2017, the EEOC's strategy broadened to include agreements that merely deterred protected employee activity. In 2014, the agency sued CVS Pharmacy alleging a pattern or practice of resistance to the rights of employees to file charges of discrimination. At issue were severance agreements that prohibited (1) "any statements that disparage the business or reputation of CVS", and (2) the improper use or disclosure of "confidential information belonging to CVS." The Seventh Circuit affirmed summary judgment in favor of CVS in *EEOC v. CVS Pharmacy, Inc.*, 809 F.3d 335 (7th Cir. 2015).

Despite this loss, the EEOC formalized its broader strategy in its Strategic Plan FY 2017-2021. This Plan is to target "waivers or releases" which merely "deter … filing charges with the EEOC, or deter … providing information to assist in the investigation or prosecution of discrimination claims."

In December 2017, EEOC Commissioner Chai Feldblum confirmed the continued intent of the agency to monitor the language of non-disclosure and non-disparagement agreements. She said: "It is important for employers to know that we are looking at these agreements." In view of this statement, it is likely the EEOC will continue to take an aggressive position in litigation regarding such agreements.

State Public Policy

States take differing approaches when analyzing the enforceability of restrictive agreements with employees. Even the deference accorded to agreements designed to protect an employer's trade secrets and proprietary data varies from state to state.

Under many state's laws, courts will not enforce agreements that violate a public policy of the state. Indeed, many cases have voided restrictive agreements that suppress information regarding criminal conduct.

Some states hold that an employee does not violate a non-disclosure agreement by orally disclosing confidential information to legal counsel in preparation for suit against the employer. In *Fox Searchlight Pictures v. Paladino*, 89 Cal.App.4TH 294, 106 Cal.Rptr.2d 906 (2001), the court found this to be a proper balance between protecting an employer's sensitive information and permitting a former employee to obtain legal counsel for her discrimination suit.

No cases have been located where a court found an employee agreement to violate state public policy to the extent it barred non-governmental disclosures of alleged harassment. In the Weinstein scandal, however, the employment and settlement agreements potentially left future potential harassment victims unwary and vulnerable. Citing the need to protect third parties, it is likely some state courts may soon bar enforcement of such agreements on public policy grounds.

> "No cases have been located where a court found an employee agreement to violate state public policy to the extent it barred … disclosures of alleged harassment"

State Legislation

State legislatures in California, New Jersey, New York and Pennsylvania already have drafted bills to regulate non-disclosure agreements. Each bill varies greatly in its scope.

In California, the Stand Together Against Non-Disclosure Act purports to ban the inclusion of secrecy clauses and/or requirements in non-disclosure agreements in cases related to specified sexual misconduct, including sexual harassment and sexual assault.

In New York, a bill voids any contract provision that requires an employee to conceal claims of unlawful conduct, including harassment.

In Pennsylvania, Senate Bill No. 999 voids any agreement that includes a provision that "(1) prohibits or attempts to prohibit the disclosure of the name of any person suspected of sexual misconduct, (2) suppresses or attempts information relevant to an investigation into a claim of sexual misconduct, (3) impairs or attempts to impair the ability of any person to report a claim of sexual misconduct to an appropriate person, (4) purports to waive a substantive right or remedy of any person relating to a claim of sexual

EMPLOYEE AGREEMENTS POST-WEINSTEIN AND #ME TOO, CONT'D

misconduct, or (5) requires or attempts to require any person to expunge information pertaining to a claim of sexual misconduct … unless due investigation determines the claim to be false."

To be sure, not all these bills will be signed into law. Employers can be certain, however, that some restriction will be passed by one or more states.

Takeaways

So, what will become of non-disclosure agreement in the future? There will likely be no reason for a material change from existing law as to employee non-disclosure agreements which purport to protect an employer's trade secrets and proprietary data. For agreements which purport to safeguard the secrecy of alleged sexual discrimination or harassment, however, a sea change may already be in the works. Just ask any employer who expected a tax deduction as part of a settlement of a sexual harassment claim.

Robert G. Chadwick Jr. is a managing member of **Seltzer Chadwick Soefje,** PLLC, in the firm's **Dallas** office. Board Certified in Labor & Employment Law by the Texas Board of Legal Specialization, he may be reached at rchadwick@realclearcounsel.com.

INSURANCE PRODUCER E&O DEFENSE STRATEGIES, BY: PETER J. BIGING, ESQ.

Defending the insurance agent/broker E&O claim can present both a number of challenges and opportunities. On the negative side of the ledger, the fact is that while it remains a recognized obligation on the part of the insured to read his/her policy in most if not all jurisdictions in the U.S., the prevailing view is that the failure to read policy documents does not present a bar to claims for negligent failure to procure, or failure to advise. The failure on the part of the insured to read his/her policy can be raised as a defense based on a comparative fault analysis. But only in a handful of remaining states can it be cited as an absolute bar to the making of such claims. Additionally, in the vast majority of jurisdictions an agent/broker is not viewed as a fiduciary, owing a duty to advise the insured as to what types of insurance to purchase, at what limits, absent a "special relationship" or "special circumstances." But the terrain has shifted on this as well. Cases addressing when a special relationship or special circumstances exist giving rise to a duty to advise have evidenced an increasing willingness on the part of the courts to accept as a foundation of its analysis that insurance policies are inherently complicated, and that agents/brokers are often retained precisely for their expertise in assisting their customers in identifying insurance risks specific to their circumstances or business operations, and helping them tailor their insurance to protect them against same.

On the plus side of the ledger, courts continue to recognize that brokers are not guarantors of the risks faced by their customers, who are much better equipped to understand the value of their holdings, the impact a particular type of loss could realistically be anticipated to have on their business operations, their risk tolerance, and what they can afford and would be willing to pay to protect themselves against risk. In light of this, it is generally recognized that it would be unfair to charge agents/brokers with the responsibility to provide advice and guidance absent a truly special relationship or special circumstances. Further, it is not simply the obligation of the insured whose coverage fails to respond to a loss in whole or in part to point to the alleged failings of the agent/broker in order to establish liability on the agent/broker's part for the uninsured loss. It remains the responsibility of the insured in proving its entitlement to relief to show that, but for the alleged negligence on the part of the agent/broker, the loss would have been covered under the policy in question. And to the extent the plaintiff had no coverage in place whatsoever, it is the burden of the insured to prove that insurance coverage for the loss would have been available, and if offered the insured would have been willing and able to pay for same.

Assuming proximate causation can be generally established, other arguments can be made to limit the value of the claims. For example, if an argument could be made that the claim would have been covered but for the agent/broker's negligence, but the claim would have been treated as multiple claims with multiple deductibles, this can be an effective way to substantially limit the recoverable damages. As another example, if the coverage the insured claims should have been purchased would have actually been purchased, it may be valid to argue that the policy would have been far more expensive. The additional premiums would have to be subtracted from the value of the claim, as there would have been no coverage save for the purchase of this coverage and the payment of these premiums. If the plaintiff insured is claiming that the coverage should have been purchased at the outset of the parties' relationship and the relationship goes back several years, the saved premiums over that entire period can arguably be applied to reduce the recovery. As still another example, it is possible that an expert or an underwriter at the carrier involved in providing the policy miss-

"Assuming proximate causation can be generally established, other arguments can be made to limit the value of claims."

ing an endorsement adding coverage the insured claims he/she asked the agent/broker to procure may be able to show that any such coverage would not have been offered without being capped at a certain limit, or that it would not have been offered or available given the risk involved, the insured's loss history, or the specific circumstances of the insured's situation that would have been taken into account during the underwriting of the risk.

While these defense arguments can be used in many cases to effectively blunt agent/broker E&O claims, it is important to note that they have to be deployed thoughtfully and with care. Sometimes the agent/broker will have a viable argument that notwithstanding the poor advice given with regard to the placement of coverage, or the inclusion of policy language via endorsement, the insured is nonetheless wholly unable to establish a credible link between the agent/broker's negligence and the damages asserted. However, while it can seem reasonable to point to a lack of clarity in connecting the dots, point to the insured's burden to prove proximate causation, and declare that for this reason the insured's E&O claim must fail, proof of loss can sometimes be complicated by the nature of the loss, and courts will take this into consideration. What might seem a sure fire proximate causation defense argument may not necessarily yield an early dispositive ruling.

A recent California appellate court decision highlights the arguments available to the broker to combat agent/broker E&O claims, and how these issues can play out in real time. Some other recent decisions provide further evidence of how these issues and arguments can play out, and the increasingly expansive view of the potential range of parties who were impacted by the agent/broker's alleged negligence who may be viewed as having standing to sue the agent/broker. The following is an analysis of the California appellate court decision, and the lessons that can be drawn from it, followed by a brief summary of some other recent agent/broker E&O decisions of note, and conclusions that can be drawn from these decisions.

Case Study – The Agent/Broker's Defenses as Applied

In *Performance Team Freight System, Inc. v. Arthur J. Gallagher & Co.*, 2017 WL 3668442 (Cal. Ct. App., Aug. 25, 2017), the insurance broker Arthur J. Gallagher ("Gallagher") was sued for professional negligence and breach of contract by its customer, a company engaged in the business of providing trucking and warehousing services ("Performance Team"), after a claim for over $1.4 million under crime insurance coverage was challenged by its insurers, and the claim was ultimately settled for just $500,000. The claim was made after it was determined that drivers hauling customer merchandise were systematically opening packages, stealing portions of the merchandise, and then re-sealing the packages before delivery. The nature of the thefts made it hard to confirm everyone who might have been involved in the scheme. Accordingly, while a number of drivers were terminated after the investigation, they were not terminated on the grounds that they had been implicated in the thefts. And it was impossible to track each piece of stolen merchandise to the specific driver believed to have stolen it. The drivers involved in the scheme apparently were all making use of a fencing operation, and the issue only came to light after stolen merchandise had been fenced.

The drivers involved were independent contractors, and the fidelity and crime coverage in issue provided that only thefts by "employees" would be covered. However, a policy endorsement negotiated by Gallagher defined employees in such a way that they could be deemed employees for the purposes of the coverage.

After commencing a lawsuit against the insurers asserting, *inter alia*, claims for declaratory relief and breach of contract, Performance Team ultimately settled their claim for the deeply discounted $500,000 figure. In its suit against Gallagher, Performance Team alleged that they were compelled to settle for far less than the actual value of the stolen merchandise because of Gallagher's negligence in procuring coverage, and specifically its alleged negligence in regards to the crafting of the language defining in what circumstances independent contractors would be deemed employees. Specifically, while the endorsement defined "employees" to include independent contractors in the regular service of Performance Team's ordinary course of business, it limited such coverage to those contractors performing services for Performance Team pursuant to a written contract between a "natural person independent contractor" and Performance Team for such services.

> "What might seem a sure fire proximate causation defense argument may not necessarily yield an early dispositive ruling."

The problem that developed was that in the course of investigating and considering the claims, the insurers raised questions about whether coverage would apply only with respect to thefts by drivers who each had individual written contracts with Performance Team. Not all did. Additionally, the insurers questioned whether some portion of the thefts might have occurred after delivery, as there was no definitive evidence that the thefts occurred prior thereto. They had also raised questions about whether there was sufficient evidence to determine the drivers involved

INSURANCE PRODUCER E&O DEFENSE STRATEGIES, CONT'D

in the thefts had all conspired and colluded with others, thus making it a single claim with a single deductible, or multiple claims.

As noted above, after settling with its insurers, Performance Team sued Gallagher, claiming it was compelled to settle for such a discounted amount because of Gallagher's negligence in regards to the inclusion of the endorsement on the policy concerning covered "employees." After taking discovery, Gallagher moved for summary judgment. The theory presented was that Gallagher could not prove "causation" because Performance Team had not identified which drivers involved in the thefts fell outside the policy's definition of employees. Thus, it was argued, they could not prove what portion, if any, of the reduced payment was caused by this.

Additionally, Gallagher argued that Performance Team could not establish that, but for Gallagher's alleged negligence, Performance Team's claim would have been fully covered. The argument in this regard was based on the fact that there were other issues that had not been resolved, including whether there definitively was collusion among the drivers, or not, and thus whether one or more deductibles would have applied. Lastly, and relatedly, Gallagher argued that Performance Team had failed to prove actual damages flowing from Gallagher's alleged negligence. Gallagher's argument in this regard prevailed at the trial court, and Performance Team's claims were dismissed on summary judgment.

On appeal, the judgment was reversed. As grounds for reversal, the appellate court pointed out that:

> Performance Team's complaint was not limited to the theory that Gallagher was negligent in negotiating and agreeing to Endorsement No. 6 because it was too narrow. The complaint *also* alleged Gallagher's breach was in **failing to procure** "full and complete crime coverage" for the risk of driver theft and by **failing to advise** Performance Team there was a gap in the company's crime coverage. This theory is that Gallagher breached its duty by failing to ensure that Performance Team's crime coverage would encompass theft by *any* of the independent contractors driving for Performance Team, irrespective of whether the driver was a "natural person" or whether there was a written independent contractor agreement. Under this theory, had Gallagher procured such coverage, it would have been unnecessary for Performance Team to show the insurer anything other than that truck drivers performing services for Performance Team committed the thefts. Endorsement No. 6 gave Federal an opportunity to challenge coverage based on the status of the drivers. Performance Team argues that had Gallagher procured the "full and complete" coverage for driver theft the company wanted, Federal simply could not have argued there was no coverage for the theft losses because of the nature of the drivers' employment, or because of a lack of proof of driver status.

Id. at *7.

As to the argument raised with respect to the fact that there were other reasons having nothing to do with the "employee" endorsement that were raised concerning the claim, the appellate court noted that Performance Team had offered evidence that it had identified the drivers, by name, that it believed had committed the thefts and provided this evidence to the lead insurer. Performance Team also attested, by counsel, that they had provided Federal with detailed supporting documentation which identified each specific item of merchandise that the client claimed was missing from their shipments. While Performance Team never specifically accused any drivers of stealing, the appellate court found this to provide sufficient evidence to establish the existence of a material issue of fact precluding summary judgment.

With regard to the collusion issue, the court noted that while Performance Team had no evidence of communications between the drivers about planning and executing the thefts, it had presented strong circumstantial evidence that there was a common conspiracy. This evidence included the fact that all of the drivers implicated were making pick-ups at specific client warehouse locations, that they all were tied to the same merchandise shortages involving opened and re-sealed cartons, and that they all moved the merchandise through the same fencing operation.

Lastly, the court noted that the fact that Federal had challenged coverage on multiple bases did not, ipso facto, negate Performance Team's assertion that but for Gallagher's negligence, it would have been able to secure a better settlement or recovery against Federal at trial. The uncertainty created by the application of the definition of who were "employees" within the meaning of the endorsement, and thus what portion of the claims might be covered, was, by itself, a significant reason why Federal did not accept coverage.

On the damages argument, because the court concluded that Performance Team's claims could not be dismissed on summary judgment on the evidence before it, the court found that the arguments Gallagher had raised were not sufficient to dismiss the claim based on an alleged inability to prove Performance Team's actual damages. In so doing, the court noted that it was insufficient for Gallagher to simply point to the fact that Federal had multiple reasons for challenging coverage. On summary judgment, it was Gallagher's burden to show that no damages could be proven because of this.

"On summary judgment, it was Gallagher's burden to show that no damages could be proven because of this."

INSURANCE PRODUCER E&O DEFENSE STRATEGIES, CONT'D

Lessons to be Learned

The significance of this decision is how it highlights some of the challenges facing brokers today, insofar as they provide more sophisticated services. In this case, Gallagher stepped in to try to help its client resolve an issue that had arisen about when thefts by independent contractors might be covered. In so doing, it went beyond purchasing an "off the shelf" product. And in so doing, it opened itself up to risk in failing to consider all of the potential theft scenarios that could arise, and how the language defining who were to be deemed "employees" or not could potentially lead to coverage disputes.

The case is also significant in how it highlights a variety of useful defense arguments available to brokers facing E&O claims, and what can be done by Plaintiffs' counsel to try to fend off these arguments. In this instance, Gallagher ultimately failed to obtain summary judgment, but the issues its counsel identified, and the manner in which they were presented evidenced some very intelligent lawyering. The fact is that, notwithstanding the very real and legitimate concerns raised by the issue regarding which implicated drivers were and weren't properly deemed covered "employees", there were a number of other coverage issues raised by Federal in the course of investigating the claim.

At the end of the day, it is the plaintiff's burden to prove the damages proximately caused by the broker's alleged negligence. This case strongly suggests that a court, viewing a set of complicated facts such as these, will not be satisfied to come to the conclusion that the broker may have acted negligently in procuring coverage, but because it's complicated to follow the threads leading from this negligent conduct to the injuries incurred as a result, the only rational solution is to let the broker off the hook. Proximate cause is a critical issue. But complexity, alone, in determining how the broker's negligence impacted the customer's lack of coverage or other harm will not be sufficient to avoid liability. On summary judgment, it will be the broker's responsibility to show how the harm cannot be attributed to the broker's negligence, in whole or in part.

Miscellaneous

Quickly surveying some additional miscellaneous holdings in agent/broker E&O cases in 2017, it is noted that, in *O.P.H. of Las Vegas, Inc. v. Oregon Mut. Ins. Co.,* 401 P.3d 218 (Nev. 2017), the court held that, absent special circumstances, a broker does not owe a duty to monitor the insured's payment of insurance premiums. In *J & A Freight Systems, Inc. v. Travelers Property & Casualty Co.*, 2017 WL 4274170 (N.D. Ill. Sept. 26, 2017), while acknowledging a duty on the part of an insured to know the import and meaning of its insurance policy, the court denied a motion to dismiss the insured's negligent misrepresentation claim based on same. The court held that an insured's duty to know the contents of his policy does not present an absolute bar to causes of action brought by an insured against an insurance agent or broker, as opposed to causes of action by an insured against an insurer.

And in *Moje v. Federal Hockey League LLC*, 2017 WL 4005920, at *2 (N.D. Ill., Sept. 12, 2017), the court held that a minor league hockey player who was blinded during a game might have standing to pursue a claim against the broker who procured liability coverage for the league in his capacity as a "proposed insured" to whom the broker owed a duty of reasonable care. This continues the trend towards courts being ever more open to the concept of a broker owing a duty of care flowing out beyond the customer it is dealing with directly.

Conclusion

As has been the case in recent years, agent/broker E&O decisions in 2017 continue to evidence a trend of courts being more receptive generally to finding bases for identifying a duty to advise, or at very least being unwilling to dispose of duty to advise claims on summary judgment. That said, whether within the realm of the "duty to advise" claim or otherwise, there are numerous viable arguments in the thoughtful defense lawyer's/claims attorney's arsenal upon which to build strong defenses to the various claims that can typically be brought against a broker when insufficient coverage is available to respond to an insured's loss. As we move deeper into the digital age, we are confronted with all the risks that are presented by the reduced interaction between human beings on both the broker side and the underwriting side. And as we continue further into this 21st century, we continue to see courts become ever more accepting of the premise that insurance is a complicated field through which the broker is seen as and expected to provide specialized expertise and guidance. With this in mind, it is important to continue to keep a close eye on the trends, consider how the issues and arguments are likely to play out, and take careful note of what can and must be done to build out the defense case.

Peter Biging is a partner in the **Goldberg Segalla** LLP **New York City** office, where he heads up the firm's New York City metro area professional liability practice. Peter can be reached at pbiging@goldbergsegalla.com.

"[A]gent/broker E&O decisions in 2017 continue to evidence a trend of courts being more receptive generally to finding bases for identifying a duty to advise … ."

PRESIDENT'S LETTER, CONT'D

er news, you all should have received Chris Jensen's e-mail soliciting program proposals for the annual meeting. The deadline for proposals is March 14, 2018. If you need assistance in fleshing out an idea or filling out a panel, we can help!

I hope you enjoy this issue of the Quarterly. Pat Eckler put a tremendous amount of work into gathering and organizing the content, and it is always on the top of my stack of reading material. And please take note of our featured committee chairs, Molly Eiden and Matt Torninsaca, the co-chairs of our Young Professionals Committee. If you know an attorney or industry professional who has been in the practice area for less than ten years, please encourage them to join this active new committee.

Finally, please calendar the dates now for our Annual Meeting in New Orleans, which will take place at the Westin Canal Place from October 3-5, 2018. It will be the best conference you attend all year. Erin

LEGAL MALPRACTICE ARBITRATION: PROBLEMS AND PUZZLES, BY: PAUL G. BOYLAN, ESQ.

Legal malpractice claims against attorney professionals are not yet the subject of widespread mandatory arbitration. Lawyers, law firms, and malpractice insurers possibly do not consider arbitration a preferred method for resolution of malpractice claims. If one assumes the view that a large number of legal malpractice claims lack merit, many lawyers understandably may prefer always to avoid arbitration and to rely instead on juries, judges, and the known protections of civil litigation. This article will briefly summarize some state and federal concepts surrounding arbitration clauses in contracts and conclude that lawyers are generally better served to avoid mandatory arbitration of malpractice claims.

Tension Between State and Federal Law as to Arbitration

Any agreement between an attorney and a client to arbitrate legal malpractice claims is governed by both federal and state law. The tension between those two bodies of law creates substantial uncertainty as to what arbitration agreements will be enforceable and, more precisely, the import of state and federal law as to any agreement to arbitrate legal malpractice claims.

Arbitration, once agreed to in writing, is in general strongly favored by state and federal law. State law and the Federal Arbitration Act, 9 U.S.C. §§ 1-16 ("FAA"), govern the enforcement, validity, and interpretation of arbitration agreements. *Kindred Nursing Centers v. Clark,* 137 S. Ct. 1421, 1426 (2017). The FAA provides that an arbitration clause in "a contract evidencing a transaction involving commerce ... shall be valid, irrevocable, and enforceable…" 9 U.S.C. § 2. Numerous states have enacted arbitration statutes which closely parallel the FAA. Those state statutes permit motions to compel arbitration in state courts and state court confirmation of arbitration awards.

Under present law, the FAA is said to "federalize" arbitration law by creating a body of federal substantive law establishing and regulating the obligation to honor a written agreement to arbitrate. *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.,* 460 U.S. 1, 25 n. 32 (1983). When state law prohibits outright the arbitration of a particular type of claim, the FAA analysis as confirmed by the Supreme Court is straightforward: the conflicting state law is "displaced" by the FAA. *Marmet Health Care v. Brown*, 565 U.S. 530, 533 (2011).

Consistent with these principles, federal and state courts in recent years have enforced arbitration of malpractice clauses in attorney-client agreements. *See, e.g., Bezio v. Draeger*, 737 F.3d 819 (1st Cir. 2013) (agreement for arbitration of malpractice claim did not violate Maine code of professional responsibility); *Davis v. Fenton*, 26 F. Supp. 3d 727, 738 (N.D. Ill. 2014); *Olson v. Jenkens & Gilchrist,* 461 F. Supp. 2d 710, 726 (N.D. Ill. 2006); *Golden v. O'Melveny & Meyers LLP*, 2016 WL 4168853, at *1 (C.D. Cal. 2016); *Smith v. Lindemann*, 2014 WL 835254, at *1 (D.N.J. 2014); *DeMartini v. Johns,* 2012 WL 4808448, at *6 (N.D. Cal. 2012).

An arbitration provision is not enforceable under the FAA or under state law, however, upon such grounds as "exist at law or in equity" for the revocation of any contract. 9 U.S.C. § 2. On that basis agreements to arbitrate can be invalidated, in principle, by "generally applicable" state law contract defenses such as fraud, duress, or unconscionability. *AT & T Mobility LLC v. Concepcion*, 563 U.S. 333, 339 (2011). To determine if a basis exists to revoke an agreement for arbitration, federal courts look to state substantive law as to the formation of contracts. *Concepcion, supra*, 563 U.S. at 339-340 (2011). Federal courts under the FAA in theory defer to state law contract interpretation. *Direct TV v. Imburgia*, 136 S. Ct. 463, 468 (2015). Federal courts in recent years have not deferred to state law, however, if the state law is viewed to be "inconsistent" with the FAA. *Id.* Recent Supreme Court cases hold that the FAA requires that all state courts in their interpretation of contracts must treat arbitration agreements on an "equal

> "This article will … conclude that lawyers are generally better served to avoid mandatory arbitration of malpractice claims."

footing" with all other contracts and that the FAA requires that state courts "not interpret state law differently" in "the context of arbitration" so as to disfavor arbitration. *Direct TV v. Imburgia*, 136 S. Ct. 463, 468 (2015). As a result, the present force of any state substantive law defense tending to invalidate arbitration agreements is not predictable and possibly of no force at all to prevent arbitration.

Practical Problems in Seeking Client Agreement to Arbitration of Malpractice Claims

If we assume for discussion that an attorney or a law firm wants to contractually agree to arbitration of future legal malpractice claims in written agreements with its clients, that contractual objective begins a process which involves substantial uncertainties and risk for the law firm as to formation of an enforceable arbitration agreement. Those uncertainties, some described immediately below, make it far from clear when and how a valid and enforceable agreement can be formed with a client as to arbitration of future malpractice claims against the law firm.

No adequate or complete guidelines exist as to how to proceed with any client as to the negotiation and execution of a written engagement letter, fee agreement, or retainer agreement (together "agreement") which mandates arbitration of malpractice claims by the client against the law firm.

Assume the hypothetical client is presented with a draft of the agreement proposed by the law firm. The proposed text includes a conspicuous mandatory arbitration term as to possible future malpractice claims and all other claims by or between the client and the law firm. The proposed arbitration term non-ambiguously says, for example, that arbitration is mandatory as to "any and all disputes" by either party with the other arising under the agreement "or as to the legal services," including any claims against the law firm for "malpractice, professional negligence, breach of fiduciary duty or any other claims."

To help the client understand any engagement letter most attorneys recommend that the client engage independent counsel to review the proposed agreement because the interests of the prospective client and the attorney may be adverse. Many clients decline to engage an independent attorney. Many are unwilling to incur the expense or the delay. The primary objective of many clients is to hire the law firm promptly in order to start, as soon as possible, whatever legal work the client wants done.

If an independent lawyer disapproves of the proposed agreement because of the arbitration term, the term can be deleted. If not deleted, the evidentiary record that the client agreed to the arbitration term after consultation with independent counsel will be harmful to the client in any future argument by the client against enforcement of the arbitration term. Must that negative fact be disclosed to the client by the law firm? Either way, the law firm and client have hit a discordant note at the very start of the fiduciary relationship between the client and the law firm.

Other substantial problems remain. Whether or not the client engages an independent attorney, most prospective clients will directly ask the law firm what the law firm recommends as to arbitration, or why the law firm is asking the client to agree to arbitration of future malpractice claims. State law canons of ethics create considerable uncertainties for any attorney as to exactly what to say and how to proceed.

The ethical obligations which govern the negotiation of an arbitration clause enforceable against a client as to future malpractice claims are found in individual state rules of professional conduct. A very similar matrix of obligations and hazards is also set forth in the ABA Model Rules of Professional Responsibility (5th ed. 2015) ("Model Rules"). That matrix, as expressed in the Model Rules, includes for example the general description of the legal profession as "unique" and largely "self governing," with a "unique responsibility" to assure that its regulations are conceived "in the public interest," and not in furtherance of "self-interest of lawyers." *Id.* Preamble § 10, 11. Other Model Rule propositions which explicitly apply are that a prospective client "may rely" on the lawyer's advice (*id.* § 1.18); that every client is entitled to explanation sufficient to permit "informed decisions," (*id.* § 1.4); and that lawyers cannot make misleading or false representations as to their services, or omit a fact necessary to make any communication to the client not misleading (*id*. §§ 7.1 and 7.2, comment 2).

> "State law canons of ethics create considerable uncertainties for any attorney as to exactly what to say and how to proceed."

When the prospective client informally asks the law firm why the law firm wants arbitration of malpractice claims, the law firm, at one extreme, can say nothing in response to that direct question. That itself is very likely not ethical because silence in that situation is very likely a material omission. That omission alone would weaken the arbitration agreement from the start. It would create a defense for the client against future enforcement of the arbitration agreement by the law firm. This defeats arbitration and is at best a very poor start and not consistent with a fiduciary relationship.

Once the law firm begins to describe arbitration to the client, the contents of the proper descrip-

LEGAL MALPRACTICE ARBITRATION, CONT'D

tions and recommendations are far from certain. A lawyer who is the primary client contact may have a rational basis to think that arbitration generally is either favorable or unfavorable to claimants. Are the views of that specific supervising lawyer required to be disclosed to the client? What the law firm says about any possible arbitration will also depend to a great extent on what specific format or procedure for arbitration is contemplated by the proposed agreement.

Assume the proposed agreement requires mandatory arbitration with the American Arbitration Association ("AAA") under its commercial arbitration rules. Does the law firm need to disclose that many highly qualified AAA arbitrators are in fact attorneys? Does fairness require a panel of three as to every malpractice claim? Of the three, does fairness require that no more than one be an attorney? Is the law firm required to disclose that discovery in arbitration is very limited? That evidentiary rules are not strictly enforced? That no jury is allowed? That rights of appeal are extremely limited, and how they are limited, and the policy reasons why that is so?

Do the disclosure obligations of the law firm depend solely on what the client asks? The future attorney-client relationship will be one of fiduciary duty involving utmost good faith. There is as a result a very strong argument that unquestionable candor and full disclosure is required by the law firm. Arbitration and arbitration procedures however, are not subjects susceptible to exact description. Must the prudent law firm, because of that, record all of its disclosures to the client as to arbitration in a written appendix to the proposed agreement? Assuming the client did not independently engage an attorney, the law firm has an inherent and troubling advantage over the client as to all of these disclosure issues.

Some experienced trial lawyers within the law firm in good faith may believe that arbitration is favorable to plaintiffs. Others, with an equally strong basis, may view arbitration as favorable to the law firm. Must either view, or both, be disclosed if directly requested by the client? Is disclosure required if the law firm is economically motivated in favor to arbitration when, for example, it views arbitration as not generally favorable to malpractice claimants? Must the law firm disclose (if true) an economic motivation based on the fact its malpractice insurer offers the law firm a greatly reduced deductible for all malpractice claims resolved by arbitration?

These uncertainties in seeking a malpractice arbitration agreement with a client, whether or not carefully documented, can become at a later date the basis for a motion by the client to revoke the arbitration agreement under state and federal law on the ground that the law firm disclosures were inadequate or omissive, or that the agreement was induced by mistake or fraud by the law firm, or that the agreement is not enforceable based on arguments as to ethical violations, unconscionability or public policy. Arguments for invalidity and revocability of an arbitration agreement based on state law in theory have considerable force in favor of revocation and against enforcement of any arbitration agreement. *Conception*, *supra*, 563 U.S. at 339-340 (2011).

These basic disclosure problems for any attorney seeking any arbitration agreement with a client have been described as "informed consent preconditions." *Hodges v. Reasonover*, 103 So. 3d 1069, 1077 (La. 2012). In *Hodges*, the court ruled that, any attorney seeking to have a client agree to mandatory arbitration must, at a minimum, disclose to the client the following legal effects of any binding arbitration agreement:

- Waiver of the right to a jury trial;
- Waiver of the right to an appeal;
- Waiver of the right to broad discovery under the state or federal rules of civil procedure;
- Arbitration may involve substantial upfront costs compared to litigation;
- Explicit disclosure of the nature of claims covered by the arbitration clause, such as fee disputes or malpractice claims;
- The arbitration clause does not limit the client's right to make a disciplinary complaint to the appropriate authorities; and
- The client has the opportunity to speak with independent counsel before signing the contract.

Hodges, supra, at 1077. Similar defenses to enforcement, such as unfair oppression, surprise, or unequal bargaining power are also sometimes referred to as "procedural unconscionability" defenses to arbitration. *AT&T Mobility v. Concepcion,* 563 U.S. 333, 340 (2011).

The Ongoing Conflict Between State Law and FAA Preemption

The Supreme Court recognizes state law limits to the enforceability of arbitration agreements under the FAA, but in recent decided cases the Court has very rarely ruled against enforcement of any arbitration agreement. In theory, an arbitration clause is not enforceable if "unconscionable" or "contrary to public policy" or if not valid under "state common law" principles. *Marmet Health Care v. Brown,* 556 U.S. 530, 533-534 (2012). These words ring hollow in recent Supreme Court case law because they are recited but pointedly not used by the Supreme Court in its rulings. Recent Supreme Court cases strongly favor enforcement of arbitration under the FAA despite state law defenses. In *Marmet* and other cases, state substantive law defenses and rules of decision interpreting contract law have been rejected because they are viewed by the Supreme Court as specific to arbitration, even when not so described by the

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LEGAL MALPRACTICE ARBITRATION, CONT'D

state courts. *AT&T v. Conception*, 563 U.S. 333 (2011).

The FAA was enacted in 1925 to provide for enforceability of maritime and other interstate commercial contracts. The purpose is to promote efficiency, enforcement of contractual arbitration, and prompt resolution of disputes. *Conception, supra*, 563 U.S. 333 at n.5 (2011). Recent Supreme Court case law under the FAA enforces those goals by uniform, very broad, and sometimes innovative rules in favor of arbitration no matter what. Under the FAA as presently applied, inequality of bargaining power is no longer a ground for non-enforcement. *Direct TV, supra*, 136 S. Ct. 463, n.3 (2015) and cases there; *AT&T Mobility v. Conception*, 563 U.S. 333, n.5 (2011). Under recent Supreme Court case law, arbitration is mandatory even if the cost of the arbitration alone will indisputably leave each claimant without any recovery and arbitration will thereby create an immunity for countless violations of federal antitrust law involving millions of dollars. *American Express v. Italian Colors*, 133 S. Ct. 2304 (2013).

No identified Supreme Court or FAA case to date, however, involves any agreement to arbitrate legal malpractice claims. States, are at present free to limit or prohibit arbitration agreements as to malpractice claims. In many state courts an arbitration provision involving attorneys will not be enforced if its inclusion in the agreement violates the Rules of Professional Conduct. *Jacob v. Norris, McLaughlin & Marcus,* 607 A.2d 142, 146 (N.J. 1992) ("Contracts that violate the [Rules of Professional Conduct] violate public policy, and courts must deem them unenforceable"). The absence of language in an arbitration provision that a plaintiff is waiving the right to seek relief in a court of law, for example, can render an arbitration provision unenforceable under state law. *Atalese v. U.S. Legal Servs. Grp., L.P.,* 99 A.3d 306, 309 (N.J. 2014).

In many if not all states, the rules of professional conduct expressly require an attorney to advise a client of the implications of any engagement agreement so as to permit the client to make informed decisions. *Cohen v. Radio–Elecs. Officers Union*, 679 A.2d 1188, 1196 (N.J. 1996). The Model Rules permit a term that requires arbitration of malpractice claims in a client agreement only if the client is fully apprised of the advantages and disadvantages of arbitration and gives informed consent to the arbitration term. ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 02–425 (2002).

State substantive law carries special constitutional import for possible subjects of arbitration because many subjects of state substantive law are exclusively within state jurisdiction. There is, for example, no federal law of domestic relations. Hart & Wechsler, *The Federal Courts and The Federal System,* 779 (2d ed. 1973). Arbitration of any subject within the exclusive power of the states presents the strongest possible argument that exclusive state authority and jurisdiction as to a subject should override the FAA.

Consider for example, a hypothetical agreement to arbitrate a divorce. If that agreement is enforced, enforcement would leave state courts with very limited power to review the outcome of an arbitrated divorce. Any such agreement very likely would be invalid, even under the FAA as presently construed, because the agreement would violate exclusive state law jurisdiction as to domestic relations. No identified Supreme Court case to date addresses the topic of exclusive state power over a subject within a putative arbitration agreement.

Regulation of attorneys is also a subject also within exclusive state power. The states alone license and, at least in the first instance, undertake to discipline licensed attorneys. A state judiciary and legislature alone arguably have exclusive jurisdiction to regulate the legal profession. In New Jersey, for example, the state constitution expressly provides that the state judiciary has full and exclusive jurisdiction over the practice of law. *Kamartos v. Palias*, 821 A.2d 531 (N.J. 2003).

> "States are at present free to limit or prohibit arbitration agreements as to malpractice claims."

The right to practice law has been described as not an inherent right of every citizen but as, instead, a "peculiar privilege" granted and continued by each state "only to those who demonstrate special fitness and moral character." *In Re Crossen*, 800 N.E.2d 552, 581 (Mass. 2008). State disciplinary rules for attorneys protect the public and to maintain confidence in the "fairness and impartiality" of the state and federal justice systems. *In re Curry*, 880 N.E.2d 388, 402-403, 406 (Mass. 2008). These exclusive state interests are unquestionably very strong. No identified Supreme Court or other federal case to date addresses either way, FAA preemption of any topic within exclusive state jurisdiction. Similarly, no case yet identified holds, either way, whether that the FAA must yield to exclusive state jurisdiction or to a state law constitutional protection such as a state constitutional right to a jury trial. *Direct TV*, *supra*, 136 S. Ct. at 468, n.1 (2015).

A crucial state law policy, including "a categorical" state constitutional protection of the right to jury trial, cannot coherently lose constitutional import solely because the state constitutional right is inconsistent with FAA arbitration. The states are "independent sovereigns in our federal system." "Because" of that, the Supreme Court has "long pre-

LEGAL MALPRACTICE ARBITRATION, CONT'D

sumed that Congress does not cavalierly preempt state law causes of action." *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996). If one assumes that a state law would prohibit arbitration of legal malpractice claims to assure jury trials and also to advance state objectives in exclusive state regulation of the legal profession, those state interests present a very strong basis for argument that the FAA does not and cannot preempt a specific state rule against arbitration as to subjects of exclusive state power. No case on point has been identified.

The final limits of FAA preemption in favor of arbitration are not yet fully known. A very small percentage of state or federal cases which reject the validity of an arbitration agreement are reviewed by the Supreme Court. State courts as a result continue to decline to enforce arbitration agreements stating, for example, that the relevant state law is not in conflict with the FAA "on a given issue," or because the invalidity of the agreement is based on "common law" as to the "unconscionability" of certain agreements. *See Wolcott v. Summerville*, 61 N.E.3d 853 (Ohio 2016).

On the other hand, state and federal courts after *Concepcion, supra*, do require arbitration in all instances in which substantive state law "categorically" prohibits arbitration of a specific subject. Any future challenge to FAA preemption based on a state law prohibition of all arbitration of legal malpractice claims as a result cannot succeed unless the Supreme Court recognizes that exclusive state law powers are of greater constitutional weight than FAA preemption as now construed. In *Preferred Care v. Alexander*, 530 S.W.3d 919 (Ky. App. 2017), for example, the court held that the FAA does not preempt a state statute if the statute does not "prohibit arbitration of a particular type of claim" and if the statute is not applied so as to "disfavor" arbitration. The literal words of these tests under present case law support preemption of any state law prohibition of arbitration of legal malpractice. *See Carter v. SSC Odin*, 976 N.E.2d 344, 360 (Ill. 2012) (holding that *Marmet* prohibits any "categorical" state rule against arbitration). In *Smith v. Lindemann*, 2017 WL 4176226, n. 1 (3d Cir. 2017), the Third Circuit, in a disposition which is not binding as precedent, expressed its view that a state law prohibition of arbitration of malpractice claims against attorneys would be preempted by the FAA. *Id*. at *3. If and when the issue is ever reached by the Supreme Court, the outcome, either way, is not predictable.

Is Non-Use of Arbitration a Better Path For Lawyers?

Mandatory arbitration of not yet identified malpractice claims creates numerous ethical issues, practical problems, and policy issues which any state at any future time may want to prohibit in the future. Those same problems have the potential to make any given arbitration clause with a client not enforceable under state law or the FAA at a future date. If the courts or legislature in a given state prohibit arbitration of malpractice claims, the constitutional impact of that change and the outcome of a challenge to the preemptive effect of the FAA would at a minimum create uncertainly as to the enforceability of all malpractice arbitration agreements in place in the involved state.

Stated differently, a law firm seeking to arbitrate malpractice claims is pursuing a contractual objective which could be defeated or made uncertain at a future date by unpredictable changes in state ethical rules or state legislation. One ruling against arbitration and in favor of revocability would leave all law firms in that state not certain as to the validity of their other arbitration agreements with clients.

Possibly a Different and Better Path is Advisable for Attorneys

When any attorney requests an arbitration agreement with a client as to malpractice claims, it cannot be denied that the attorney views arbitration as more favorable to the lawyer than civil litigation. That, by definition, is "self-interest." Lawyers, however, must be guided by contrary ethical precepts, including the precept that "self-governance" must be done in the "public interest" and not in pursuit of "self-interest." Model Rules, Preamble, §§ 10, 11. These precepts alone argue for the voluntary non-use of malpractice arbitration by lawyers at this time.

Non-use of arbitration for malpractice claims will demonstrate attorney confidence in jury trials and judges. Those are the best known features of our civil justice system. Non-use of arbitration also has other more concrete advantages. Non-use eliminates the need for litigation to compel arbitration and disputes as to state law defenses to arbitration, e.g. that the agreement to arbitrate malpractice claims is not enforceable and is revocable because the lawyer was not ethical when introducing the client to the agreement. State law defenses will cause many malpractice claims subject to arbitration to morph into two disputes, the first a dispute as to whether the arbitration agreement is enforceable, the second the trial or arbitration on the merits of the claim. Collateral disputes as to arbitration will always put lawyers in a bad light because judicial enforcement of an arbitration term as to malpractice signals to the public that a law firm accused of malpractice wants to avoid a public jury trial of the claim. Enforcement of arbitration agreements as to malpractice thereby puts attorneys

"These precepts alone argue for the voluntary non-use of malpractice arbitration by lawyers at this time."

LEGAL MALPRACTICE ARBITRATION, CONT'D

in the position of avoiding some of the best-known features of our civil justice system, including public trials by jury, judicial supervision of trials, and full appellate review.

Voluntary non-use of agreements to arbitrate malpractice claims offers the legal profession a chance to take the ethical high road. Non-use will increase public trust in the profession by avoidance of self-interest. The legal and practical problems described here are, on this view, an opportunity for lawyers to affirm the unique and important role of judges and civil jury trials in our justice system. That affirmation promotes respect for the profession and public confidence in the most crucial features of our civil justice system.

Paul G. Boylan is a shareholder in the **Boston** office of **LeClairRyan** LLC. His practice involves the defense of professionals and other defendants in civil litigation. The views expressed in this article are the author's alone. Paul may be reached at paul.boylan@leclairryan.com

PROFESSIONAL LIABILITY DEFENSE FEDERATION FEATURED COMMITTEE LEADERSHIP

YOUNG PROFESSIONALS
MOLLY A. EIDEN, CHAIR

Molly A. Eiden is a Claim Attorney with Minnesota Lawyers Mutual Insurance Company. She is a graduate of the University of Wisconsin at Madison, and the Hamline University School of Law. She then entered private practice before joining MLM in 2014. Molly also serves as an Adjunct Professor at the Mitchell Hamline School of Law.

As a Claim Attorney, Molly manages LPL claims for policyholders. Molly is a member of the Minnesota Defense Lawyers Association and holds the C.P.C.U. and R.P.L.U. designations. She may be reached at meiden@mlmins.com.

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Eris Bryan Paul received his Bachelor of Science and Juris Doctor degrees from the University of Alabama. He is a partner with Huie Fernambucq & Stewart LLP in Birmingham, Alabama. Bryan practices in the fields of professional liability, appellate, insurance coverage, real estate, and workers compensation. He is admitted to practice in the federal and state courts of Alabama.

Bryan has appeared in most of the state's 41 judicial circuits and three federal districts in Alabama. He is a member of the Alabama Defense Lawyers Association and the Defense Research Institute. He may be reached at bpaul@huielaw.com.

LAWYERS PROFESSIONAL LIABILITY
ALICE M. SHERREN, CO-CHAIR

Alice M. Sherren is a Claim Attorney with Minnesota Lawyers Mutual Insurance Company. Since joining MLM in 2009 Alice directs the defense of LPL claims and speaks on risk management and ethics matters. She is a *summa cum laude* graduate of Gustavus Adolphus College, and a *magna cum laude* graduate of the University of Minnesota Law School.

After law school Alice served as a Minneapolis litigator for a decade before joining MLM. She serves on the Professionalism Committee of the Minnesota State Bar Association. Alice may be reached at asherren@mlmins.com

LAWYERS PROFESSIONAL LIABILITY
PETER L. GREGORY, VICE CHAIR

Peter L. Gregory is a shareholder with Bassford Remele, P.A., in Minneapolis. Peter defends lawyers in legal malpractice and ethics claims. He also defends medical negligence claims against physicians, and claims against long term care facilities and providers including skilled nursing facilities, assisted living facilities, group homes, CD treatment facilities, and home nursing agencies.

Peter is a *cum laude* graduate of the University of St. Thomas Law School, and before private practice he served as a judicial law clerk for the Minnesota Court of Appeals. He may be reached at pgregory@bassford.com.

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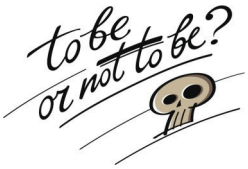
The Standard of Care PLDF ™

As our Peter Gregory, PLDF's LPL Committee Vice Chair, reported in a committee blog post, on February 7, 2018 the Minnesota Supreme Court decided *Frederick v. Wallerich*, 2018 WL 735829 (Minn. Feb. 7, 2018). Professional Liability Defense Federation filed an amicus brief in the case. Facts summary is that defendant counsel drafted an antenuptial agreement in 2006 without witness signatures, making it unenforceable. Counsel then drafted a will for client in 2007 that incorporated the antenuptial by reference, leaving nothing else for the spouse. Counsel continued with estate planning in successive years. Divorce followed n 2013, and spouse argued antenuptial was unenforceable. Client sued counsel for legal malpractice claiming asset value increase damages (owed to spouse) since he would have divorced earlier had he known of the agreement's unenforceability. Counsel filed Rule 12 motion contending claim was barred by the six-year SOL which accrued when error was made in the antenuptial's witness requirement. Client argued a new claim arose in 2007 when the will was drafted, incorporating the antenuptial, and that claim was within the SOL. Trial court dismissed case and appeals court affirmed. Those rulings were reversed by a divided court (4-2). Court ruled multiple acts of alleged negligence can give rise to new causes of action triggering separate SOL accrual periods. It rejected spouse's plea that a lawyer has a duty to consult the law and revisit the facts each time client seeks subsequent advice. It reiterated its support for the "some damage" rule of SOL accrual, and its rejection of the continuous representation theory. In sum the court - whose majority is generally allied with plaintiffs - gave spouse a Rule 12 break. Whether it survives Rule 56 remains to be seen, but in general this court is inclined to give litigants their day in court. *The Editor*

!IMPORTANT *PROFESSIONAL LIABILITY DEFENSE QUARTERLY* NOTICE!

"To 'e' or not to 'e', that is the question."
William Shakespeare, *Hamlet*, Act III, Scene I



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Delivery by U.S. Mail was the way,
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