2010 ANNUAL REPORT

Oregon State Bar

PROFESSIONAL LIABILITY FUND

www.osbplf.org

By Ira R. Zarov

PLF Chief Executive Officer

As attorneys covered by the Professional Liability Fund (PLF) know, the basic assessment was increased by $300 in 2011. The increase is the first in five years and follows three years of fluctuating fiscal results – a very difficult year in 2008 in which the PLF Primary (mandatory) Program lost $7.5 million (primarily due to the worldwide recession), a sound recovery year in 2009, and a modest gain of $730,000 in 2010. The 2010 financial statement was buoyed by the strong fourth-quarter investment gains, which cushioned claim results of approximately $1.1 million more than predicted by previous actuarial reports.

In 2010, the PLF had 938 new claims. This claim count is consistent with the precipitous increase in claim frequency that occurred in 2008 and 2009. The cautious optimism that the claim count might return to pre-2008 figures has not been realized. As points of reference, there were 781 claims in 2007, jumping to 901 in 2008, and then up to 973 in 2009. Current claim numbers extrapolated over the remainder of 2011 would result in a record number of PLF claims – 988. The difference between the 2007 claim costs and the projected cost of claims in 2011 is almost $4.5 million.

The increase in claim costs is partially driven by increased frequency, but the average cost per claim has increased as well. The average cost per claim for the first half of 2011 has risen to $19,500 from $19,000 at the start of 2010. In previous periods when claim frequency rose, claim severity often stayed stable. This has not been the case recently. The increase in frequency is generally consistent across all types of claims, and while it is difficult to assign a reason, the high unemployment rate and slow economic recovery are likely causes. Malpractice insurers in other states also speculate that the number of newly graduated or displaced attorneys beginning practices of their own is also a contributing factor.

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PLF Statistics

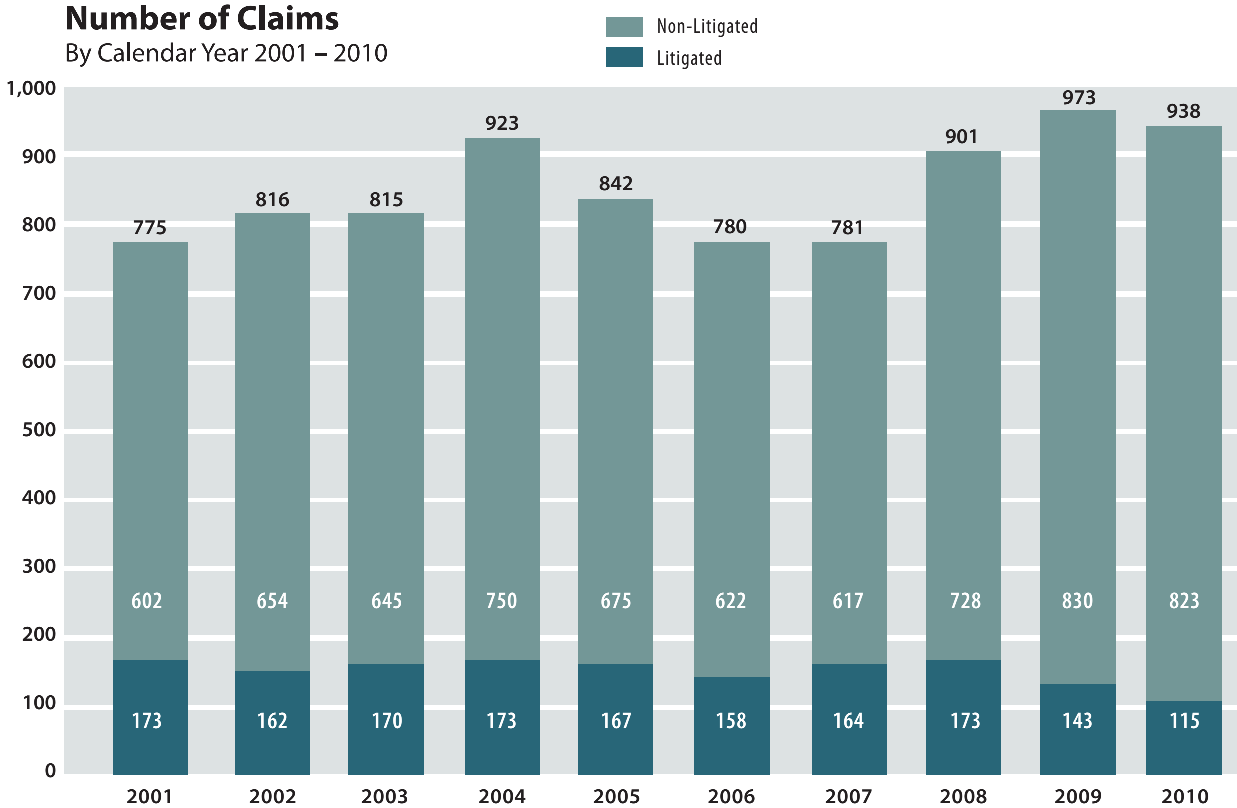
1996 – 2011

	Assessments	Claims
1996	$2100	721
1997	$2200	769
1998	$2100	761
1999	$1900	830
2000	$1800	798
2001	$1800	775
2002	$2200	816
2003	$2600	815
2004	$2600	923
2005	$3000	842
2006	$3000	780
2007	$3200	781
2008	$3200	901
2009	$3200	973
2010	$3200	938
2011	$3500	988*

* Extrapolated

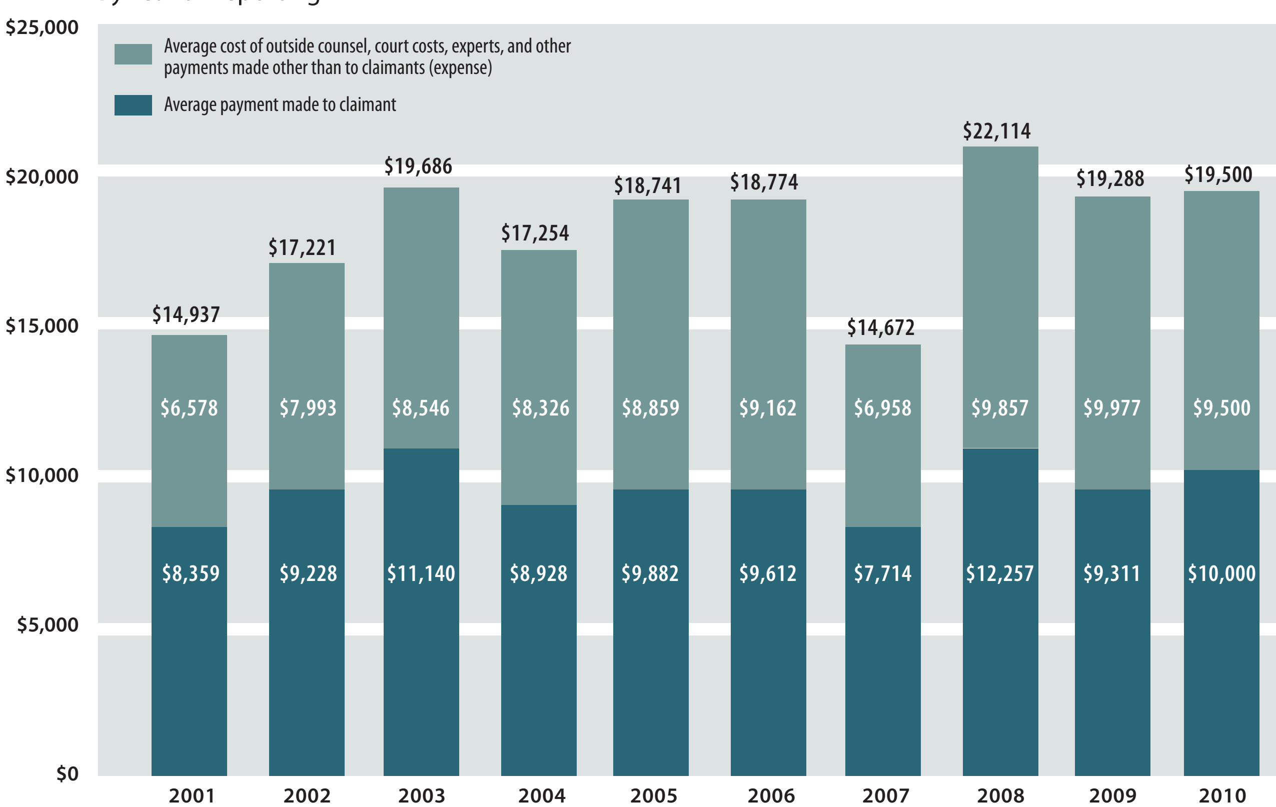
Number of Claims

By Calendar Year 2001 – 2010



Average Cost per Claim

By Year of Reporting



SUMMARY FINANCIAL STATEMENTS (Unaudited)

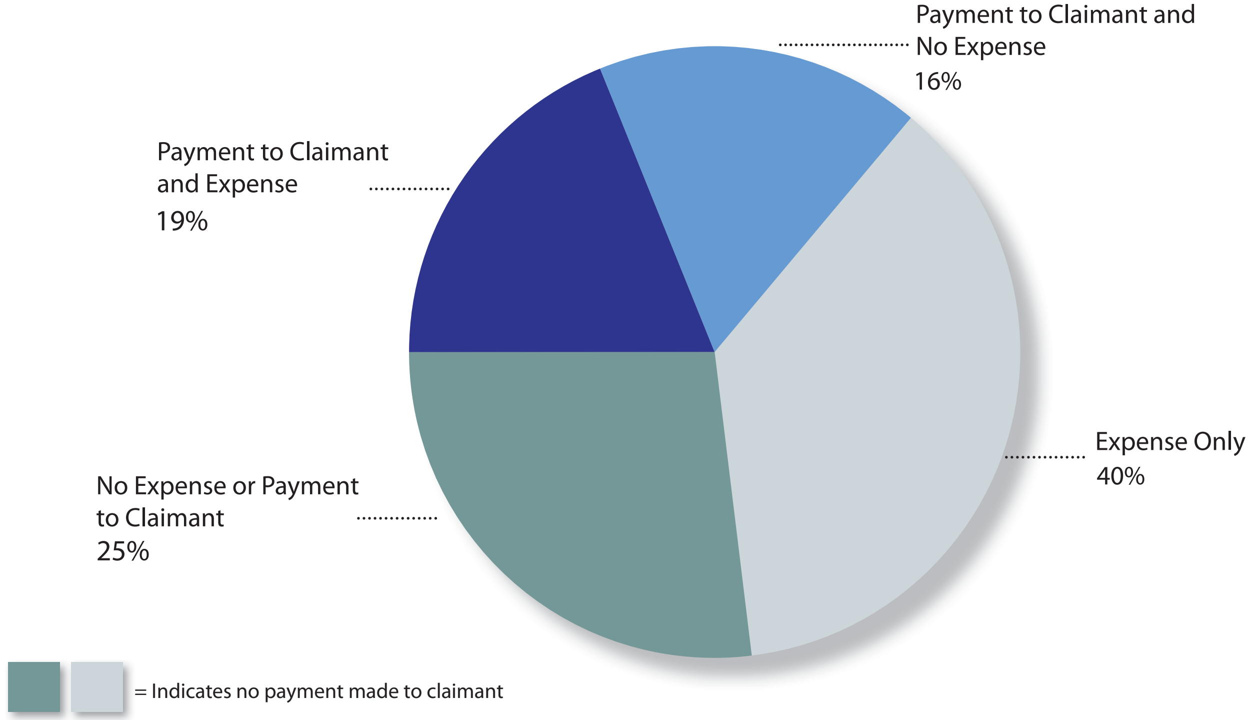
(Primary and Excess Programs Combined)

	12/31/2010	12/31/2009
ASSETS		
Cash and Investments at Market	$33,415,582	$30,545,197
Other Assets	1,293,798	1,462,196
TOTAL ASSETS	**$34,709,380**	**$32,007,393**
LIABILITIES AND FUND EQUITY		
Estimated Liabilities for Claim Settlements and Defense Costs	$31,900,000	$29,800,000
Other Liabilities	459,949	487,006
Fund Equity	2,349,431	1,720,387
TOTAL LIABILITIES AND FUND EQUITY	**$34,709,380**	**$32,007,393**

	For the Year Ending December 31	
	2010	2009
REVENUE		
Assessments	$22,244,406	$21,913,959
Investment and Other Income	5,119,157	6,525,384
TOTAL REVENUE	**$27,363,563**	**$28,439,343**
EXPENSE		
Administrative	$6,791,936	$6,684,261
Provision for Settlements	9,346,993	10,071,924
Provision for Defense Costs	10,595,590	8,667,863
TOTAL EXPENSE	**$26,734,519**	**$25,424,048**
NET INCOME	**$629,044**	**$3,015,295**

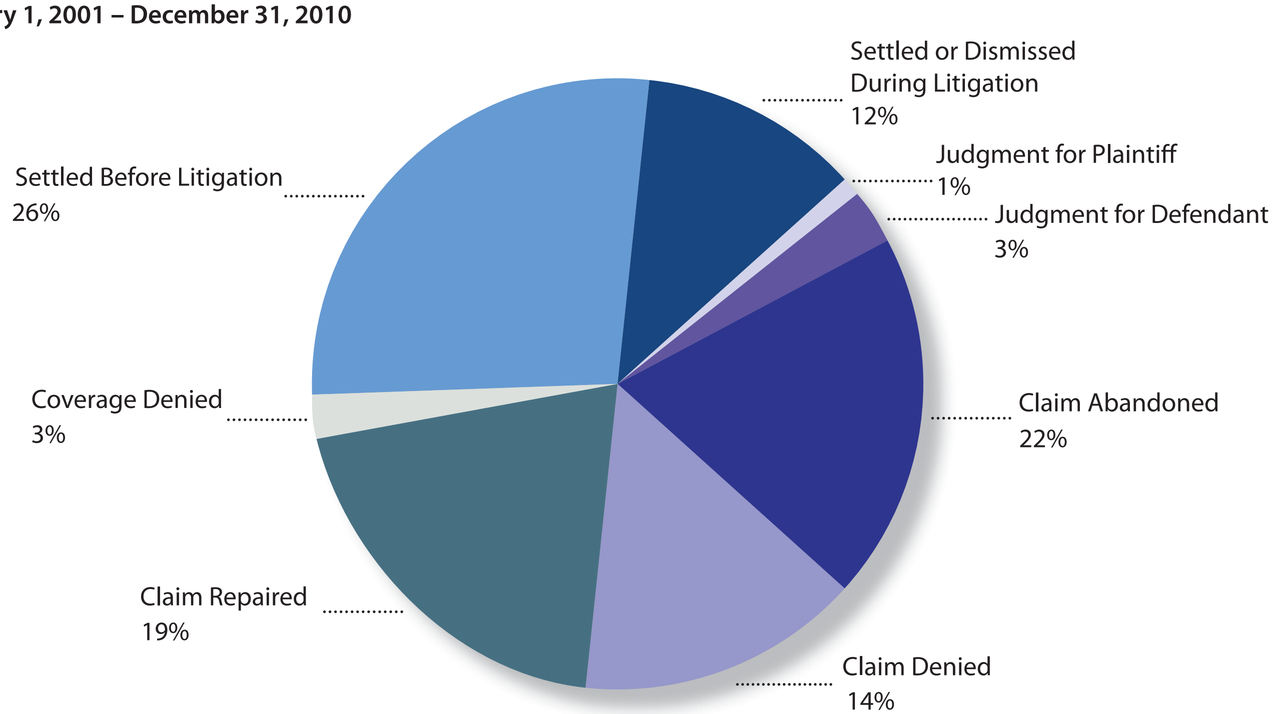
These statements have been adjusted to remove prepaid assessments (e.g., payments of the 2011 assessment received in December of 2010). A complete copy of the December 31, 2009, audit report is available on request.

Closed Claims
January 1, 2001 – December 31, 2010



Expense = Cost of outside counsel, court costs, experts, and other payments made other than to claimants

Disposition of Closed Claims
January 1, 2001 – December 31, 2010



Cost of Claims by Area of Law

January 1, 2001, through December 31, 2010

AREA OF LAW	PERCENT INDEMNITY PAID	INDEMNITY PAID	PERCENT EXPENSES PAID	EXPENSES PAID	TOTAL PAID
Personal Injury	19%	$12,930,867	13%	$6,805,458	$19,736,325
Business Transactions / Commercial Law	14%	$9,189,457	16%	$8,758,500	$17,947,957
Real Estate	16%	$10,963,957	13%	$6,818,043	$17,782,000
Estate Planning & Estate Tax	11%	$7,591,927	10%	$5,364,155	$12,956,082
Domestic Relations / Family Law	9%	$6,012,917	9%	$5,054,861	$11,067,778
Bankruptcy & Debtor-Creditor	9%	$6,055,176	8%	$4,339,641	$10,394,817
Workers' Compensation / Admiralty	4%	$2,646,740	2%	$966,185	$3,612,925
Criminal	2%	$1,503,042	3%	$1,747,150	$3,250,192
Securities	2%	$1,403,480	4%	$1,813,682	$3,217,162
Tax	1%	$884,195	3%	$1,497,422	$2,381,617
Other	13%	$8,678,399	19%	$10,166,365	$18,844,764
	100%	**$67,860,157**	**100%**	**$53,331,462**	**$121,191,619**

Frequency of Claims by Area of Law

January 1, 2001, through December 31, 2010

AREA OF LAW	PERCENT OF CLAIMS	NUMBER OF CLAIMS
Personal Injury	17%	1,311
Domestic Relations / Family Law	16%	1,228
Bankruptcy & Debtor-Creditor	12%	946
Real Estate	11%	872
Estate Planning & Estate Tax	10%	786
Business Transactions / Commercial Law	9%	704
Criminal	7%	510
Workers' Compensation / Admiralty	3%	197
Securities	1%	61
Tax	1%	59
Other	13%	1,065
	100%	**7,739**

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In summary, the 2010 results saw claim costs exceed previous actuarial predictions and found claim frequency at the highest end of projections.

THE 2012 PRIMARY PROGRAM ASSESSMENT

The 2011 assessment was calculated to achieve four goals: (1) provide sufficient income to meet the costs of 2011 claims; (2) provide sufficient income to fully fund the cost of older claims and absorb the cost of potentially negative claim development; (3) provide stability to the assessment as long as possible; and (4) move the PLF toward the goal of providing a reserve to stabilize future assessments. In the past, including 2009, the reserve policy allowed the PLF Board of Directors to avoid raising the assessment when economic conditions for lawyers were stressful.

As the process of determining the 2012 assessment unfolds, the Board has some added security based on the 2011 increase. In addition, the better-than-expected investment results softened the impact of the negative claim development and provided a positive factor when projecting the need for a 2012 increase. On the negative side, the slow economic recovery, the potential for a less robust future investment performance, and the empirical nexus between difficult financial times and increased claim frequency and severity all remain a concern.

Despite these crosscurrents, the PLF is reasonably optimistic that the assessment will not need to be increased in 2012. The Board recognizes that economic challenges for lawyers and law firms remain and is committed to making every effort to maintain the assessment at its current rate in 2012. The 2012 assessment will be determined midyear 2011, when more is known about overall claim development.

HOW IS THE PLF DOING WITH CLAIMS HANDLING?

Historically, covered parties who returned the PLF claims-handling evaluation form have been overwhelmingly satisfied with the performance of the PLF claims department. That result was replicated in 2011.

The claims-handling evaluation form asks whether covered parties were "satisfied," "very satisfied," or "not satisfied." In 2010, the PLF received 468 responses (a 45% response rate). The responses gave high ratings to both claims attorneys and defense counsel.

The performance of claims attorneys was particularly noteworthy, with 93.8% of respondents stating that they were "very satisfied" with how their claim was handled, 6% stating that they were "satisfied," and only 0.2% stating that they were "not satisfied" – remarkable numbers. In total, 99.8% of the respondents were "very satisfied" or "satisfied" with the PLF claims attorneys' handling of the claim.

Covered parties' satisfaction with defense counsel was also very high. Among the 262 covered parties who responded to the questionnaire about defense counsel, 89% were "very satisfied," 10.6% were "satisfied," and just 0.4% were "unsatisfied." (The fewer responses regarding defense counsel reflect the fact that many cases are handled by the PLF claims attorneys without being assigned to defense counsel.)

The combined average responses for claims attorneys and defense counsel totaled 91.4% "very satisfied" and 8.3% "satisfied" – 99.7% either "very satisfied" or "satisfied."

WHAT IS THE PLF DOING IN THE AREAS OF PERSONAL AND PRACTICE MANAGEMENT ASSISTANCE?

The PLF continues to provide free and confidential personal and practice management assistance to Oregon lawyers. These services include legal education, on-site practice management assistance (through the PLF's Practice Management Advisor Program), and personal assistance (through the Oregon Attorney Assistance Program).

Personal and practice management assistance seminars in 2010 included programs on software updates, malpractice traps in debtor/creditor issues, technology tips, practice management, financial topics, health insurance, and job search skills. In addition, we con-

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tinue to offer free audio and video programs (currently 53 programs are available), publications (*In Brief* and *In Sight*), over 348 practice aids, and the following handbooks: *Planning Ahead: A Guide to Protecting Your Clients' Interests in the Event of Your Disability or Death* (2009), *A Guide to Setting Up and Running Your Law Office* (2009), *A Guide to Setting Up and Using Your Lawyer Trust Account* (2011), and *Oregon Statutory Time Limitations* (2010). Our practice aids and handbooks are all available free of charge. You can download them at **www.osbplf.org**, or call the Professional Liability Fund at 503-639-6911 or 800-452-1639.

During 2010, the PLF presented video replays of the following programs: Malpractice Traps Involving Debtor/Creditor Issues in Real Estate and Business Cases; Avoiding Malpractice in Family Law; Employment Practices for Lawyers; Practical Law Office Solutions for Sole and Small Firms; Money Matters; Access to Justice; Recognizing Child Abuse and Fulfilling Your Duty to Report; and The Ethics of Practice Management. These video replays were presented in Bend, Eugene, Grants Pass, Newport, Redmond, Roseburg, Salem, and Vale, Oregon.

Practice Management Advisor Program. Our practice management advisors (PMAs), Dee Crocker, Beverly Michaelis, and Sheila Blackford, answer practice management questions and provide information about effective systems for conflicts of interest, mail handling, billing, trust accounting, general accounting, time management, client relations, file management, and software. In a recent survey about our PMAs,

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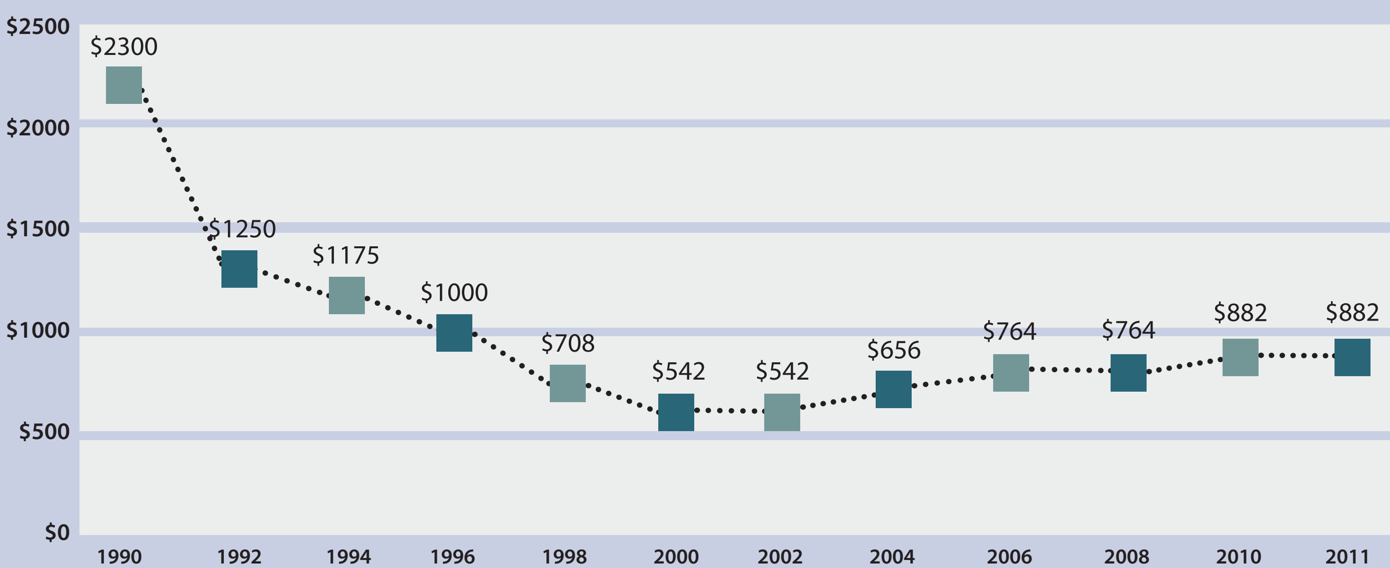
Cost of Excess Coverage – Standard Rates
By Calendar Year 1990 – 2011



Figures are the cost per attorney of $700,000 PLF excess coverage above the primary limits. Figures for 1995 to 2011 do not include the continuity credit granted to firms for each year of continuous excess coverage with the PLF. Figures are not adjusted for inflation.

100% of those who responded said they would recommend the PLF's practice management advisor services to others. In addition, 100% said they were either "satisfied" or "very satisfied" with the ability to reach a PMA by telephone, the promptness with which their phone calls were returned, their treatments, the timeliness of appointments, the PMA's ability to explain information, the helpfulness of the information to their needs, and the follow-up. In 2010, the PMAs presented live programs in Albany, Astoria, Baker City, Bend, Coos Bay, Corvallis, Eugene, Gold Beach, Klamath Falls, La Grande, Lincoln City, Medford, Ontario, Pendleton, Prineville, Roseburg, and Tillamook, Oregon.

Oregon Attorney Assistance Program. The Oregon Attorney Assistance Program (OAAP) attorney counselors, Meloney C. Crawford, Shari R. Gregory, Mike Long, and Douglas Querin, continue to provide assistance with alcohol and chemical dependency; burnout; career change and satisfaction; depression, anxiety, and other mental health issues; stress management; and time management. In 2010, the OAAP sponsored addiction support groups, lawyers-in-transition meetings, career workshops, a depression support group, a support group for lawyers going through divorce, an "Inner Peace for Busy People" workshop, a women's support group, a support group for adult children of dysfunctional families, a men's support group, and a group for overcoming procrastination. In addition, the OAAP attorney counselors assisted over 713 lawyers with personal issues in 2010, including alcoholism, drug addiction, career satisfaction, retirement, and mental health issues.

CHANGES TO THE COVERAGE PLAN

In 2010, the PLF Board of Directors and the Oregon State Bar (OSB) Board of Governors approved four changes to the 2011 Coverage Plan (Plan).

The first change extends the scope of a "beneficiary" in Section III.3 to cover lawyers acting in special capacities such as trustees and guardians. This change clarifies that a "beneficiary" does not solely mean a "named beneficiary"; it may now also include a third-party claimant who claims to be a beneficiary.

Section III.3 was revised as follows (addition in italics and bold; deletion noted by strikethrough):

> **3.** Any act, error, or omission committed by YOU in YOUR capacity as a personal representative, administrator, conservator, executor, guardian, guardian *ad litem*, special representative pursuant to ORS 128.179, or trustee (except BUSINESS TRUSTEE); provided that the act, error, or omission arose out of a COVERED ACTIVITY as defined in Subsections 1 and 2 above, and the CLAIM is brought by or for the benefit of ~~the~~ ***a*** beneficiary of the special capacity relationship and arises out of a breach of that relationship.

A second change was made to Section IV.2. This section now specifically states that all types of discretionary expenses reduce the CLAIMS EXPENSE ALLOWANCE, regardless of whether an actual claim has been made. This new language makes the Plan consistent with how the PLF and covered parties were generally viewing the application of this section.

Section IV.2 was revised as follows (additions in italics and bold; deletions noted by strikethrough):

> **2.** Defense
>
> Until the CLAIMS EXPENSE ALLOWANCE and the Limits of Coverage extended by this Plan are exhausted, the PLF will defend any SUIT against a COVERED PARTY seeking DAMAGES to which this coverage applies. The PLF has the sole right to investigate, repair, settle, designate defense attorneys, and otherwise conduct ~~the~~ defense***,*** ~~or~~ repair***, or prevention*** of any CLAIM ***or potential CLAIM***.
>
> With respect to any CLAIM ***or potential CLAIM*** the PLF defends or repairs, the PLF will pay all CLAIMS EXPENSE the PLF may incur. All payments for EXCESS CLAIMS EXPENSE will reduce the Limits of Coverage.
>
> If the CLAIMS EXPENSE ALLOWANCE and Limits of Coverage extended by this Plan are exhausted prior to the conclusion of any CLAIM, the PLF may withdraw from further defense of the CLAIM.

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The third change pertains to Exclusion 11 of Section V of the Plan that excluded claims "asserted by" family members. The comment to the exclusion states, "Work performed for family members is not covered under this Plan," which was arguably broader than the language in the actual exclusion. The PLF's intent is that if an attorney performs legal services for a family member, there is no coverage; however, there could be coverage if one attorney in the firm performs legal work for another firm attorney's family member. The comment is more in line with this intent than the exclusion, so the wording of the exclusion has been changed.

The Exclusion in Section V.11 has been revised as follows (additions in italics and bold; deletions noted by strikethrough):

> **11.** This Plan does not apply to any CLAIM ~~asserted by~~ ***based upon or arising out of*** YOUR ***legal services*** ~~to~~ ***performed on behalf of YOUR*** spouse, parent, step-parent, child, step-child, sibling, or any member of YOUR household, or on behalf of a business entity in which any of them, individually or collectively, have a controlling interest.

The fourth and final change was made to Exclusion 16 of Section V regarding general tortious conduct. The definition of "property" was expanded to include the words "real," "personal," and "intangible" to provide clarification.

Exclusion V.16 was revised as follows (additions in italics and bold):

> **16.** This Plan does not apply to any CLAIM against any COVERED PARTY for:
>
> Bodily injury, sickness, disease, or death of any person;
>
> Injury to, loss of, or destruction of any ***real, personal, or intangible*** property or loss of use thereof; or
>
> Mental anguish or emotional distress in connection with any CLAIM described under Subsections a or b.
>
> This Exclusion does not apply to any CLAIM made under ORS 419B.010 if the CLAIM arose from an otherwise COVERED ACTIVITY.

The comments to the exclusion have been made consistent with this change. Specifically, paragraph three of the comments now reads (additions in italics and bold):

> Subsection b of this exclusion ***is intended to encompass a broad definition of property. For these purposes, property includes real, personal and intangible property (e.g. electronic data, financial instruments, etc.) held by an attorney. However, Subsection b*** is not intended to apply to the extent the loss or damage of property materially and adversely affects an attorney's performance of professional services, in which event the consequential damages resulting from the loss or damage to property would be covered. For the purposes of this Comment, "consequential damages" means the extent to which the attorney's professional services are adversely affected by the property damage or loss.

EXCESS PROGRAM

The PLF Excess Program participation remained stable. In 2010, 687 firms with a total of 2,351 lawyers purchased PLF excess coverage. Only two changes were made to the 2011 PLF Excess Claims Made Plan this year. The changes follow those made to Section III.3 of the PLF 2011 Primary Claims Made Plan regarding the role of a beneficiary and to Exclusion 11 of Section V clarifying claims by family members.

As in the past, the PLF Excess Program is entirely reinsured and financially independent from the PLF's mandatory Primary Coverage Program. Because of the success of the PLF Excess Program, we are able to negotiate very favorable reinsurance rates. That savings is passed on to Oregon lawyers in lower excess coverage rates. We continue to offer continuity credits of 2% for each year of participation (up to 20%).

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CHANGES IN PLF BYLAWS AND POLICIES

No changes were made to the 2010 PLF Bylaws. Several changes were made to the 2010 PLF Policies.

POLICY 4.400 – SETTLEMENT AUTHORITY

Policy 4.400 governs the levels of settlement authority of claims attorneys, the PLF Director of Claims, and members of the Board of Directors. Prior to the change of policy, claims attorneys could settle cases up to $25,000 on their own authority. Authority for claim settlements between $25,001 and $50,000 was held by the Director of Claims. Authority for claim settlements between $50,001 and $100,000 was held by a member of the Board, that is, the assigned Director. (Each case in this range was assigned to a Board member.) For claims above $100,000, the Board was required to consider the proposed settlement, and, after Board consideration, the settlement had to be approved by the assigned Director and the CEO. These levels of authority had been unchanged since 1987. (Until 1991, the PLF had no Director of Claims. This authority was held by the PLF CEO.)

Under the revised policy, claims attorneys with more than three years' experience now have authority to settle claims up to $50,000. The PLF Director of Claims has authority to settle claims up to $100,000. For claims between $100,001 and $150,000, the approval of the assigned Director is required. Settlements above $150,000 require the same procedure as that previously in effect for claims over $100,000.

The new levels of settlement authority reflect the increases in the cost of claims since 1987 and are intended to provide the same relative authority.

POLICY 5.200 – INVESTMENT GUIDELINES

Each year the PLF Board examines its investment guidelines to ensure they will provide the best results in the current economic conditions. The guidelines specify the categories of investments and the percentage of PLF funds that should be held in each category. The general categories include fixed income, U.S. and international equities, real estate, and several other investment vehicles. The process is aided by a rigorous analysis done by an independent investment advisement firm.

This year the PLF Board was advised to make several small changes to the investment allocations. The changes decreased the percentage of funds allocated to U.S. and international equities and increased the target percentage for the "Real Return Strategy." The changes are designed to enhance the diversification of the PLF portfolio and specifically to respond to predicted future inflationary pressures.

FORECAST FOR THE FUTURE

Many factors underlie the process of setting the annual PLF assessment – projections of income, operational costs, projections of the number of claims, defense expenses related to claims, and indemnity paid on claims. Of these, only operational costs, which are a small percentage of the total budget, can be predicted with certainty. Currently, claim frequency is high but within the predicted range; defense expenses appear to be rising, while indemnity costs appear to be remaining stable. A definitive analysis will not be known until the midyear actuarial report is received. Experience has shown that legal malpractice claims are volatile, as are the economic times; accordingly, circumstances may change over the remainder of the year. The Board will carefully monitor developments as it awaits the midyear actuarial report.

If you have questions or suggestions about the PLF, please contact me.

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