2012 ANNUAL REPORT

Oregon State Bar

PROFESSIONAL LIABILITY FUND

www.osbplf.org

By Ira R. Zarov

PLF Chief Executive Officer

The 2013 assessment for the PLF Primary Claims Made Plan remained unchanged at $3,500. The assessment's stability over the recent past reflects the PLF Board of Directors' commitment to maintain a predictable cost for PLF coverage despite the inherent volatility of legal malpractice claims. Comparison of the 2011 and 2012 claim years demonstrates the volatility of results. Those two years saw a swing of almost $2.5 million in claim costs alone. Except in rare years when investment results are either extraordinarily good or extraordinarily bad, the majority of PLF gains and losses are driven by claim results. The cost of claims is approximately three times all other expenses.

The PLF had a strong 2012, posting a gain of $4.8 million. The gain was primarily the result of a decrease in the number of claims predicted. The financial results also benefitted from robust investment performance. The gain of $4.8 million has helped the PLF make progress toward the goal of reaching a prudent surplus, which would allow the PLF Board to stabilize the assessment in the event of unexpected poor claim results. Total fund equity is now approximately $4 million.

In 2012, the PLF had 1030 new claims. But for an unprecedented anomaly, this claim count would be the highest in PLF history by a large margin. The count was distorted by 141 claims made against a single covered party no longer in the practice of law. Because only one limit was implicated in the 141 claims, they were counted as a single claim. As a result, the claim count chosen for 2012 is 890. While lower than in the past four years, the 890 claims represent an almost 14% increase since 2007. In contrast, the number of covered parties has increased by only 7% since 2007.

While the claim count remains high relative to pre-2007 years, the actuaries did not increase the projected claim cost for 2013. The actuarially determined average cost per claim for the first half

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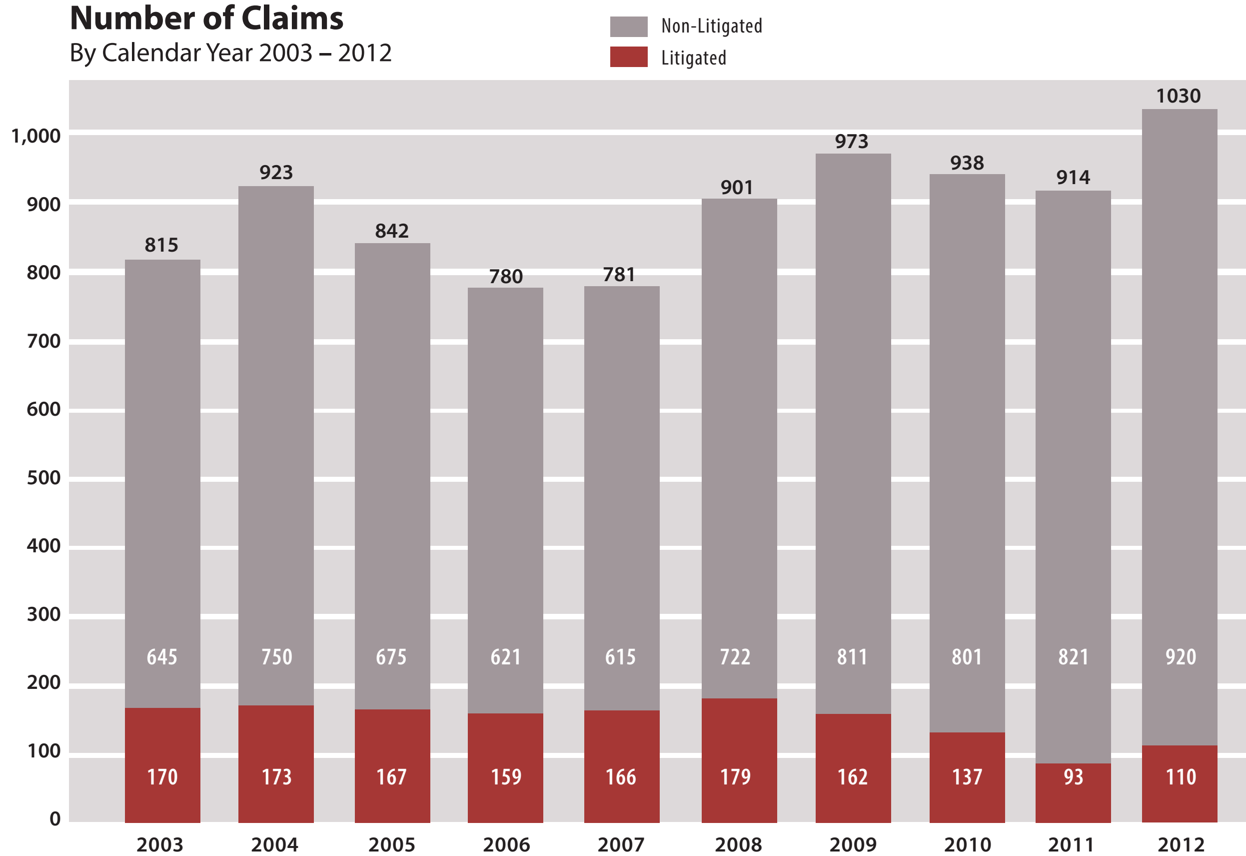
PLF Statistics
1998 – 2013

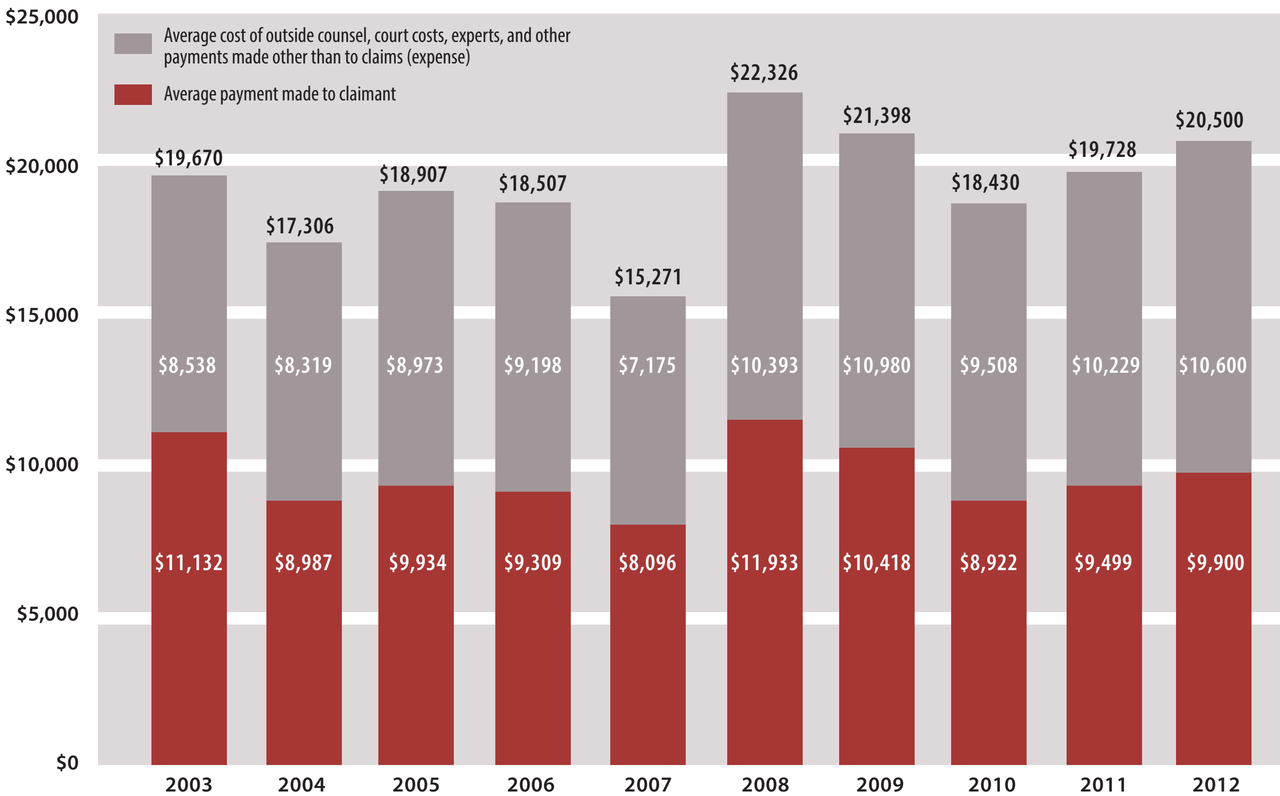
	Assessments	Claims
1998	$2,100	761
1999	$1,900	830
2000	$1,800	798
2001	$1,800	775
2002	$2,200	816
2003	$2,600	815
2004	$2,600	923
2005	$3,000	842
2006	$3,000	780
2007	$3,200	781
2008	$3,200	901
2009	$3,200	973
2010	$3,200	938
2011	$3,500	914
2012	$3,500	890
2013	$3,500	1,040*

* Extrapolated

Number of Claims
By Calendar Year 2003 – 2012



Average Cost per Claim
By Year of Reporting



SUMMARY FINANCIAL STATEMENTS (Unaudited)

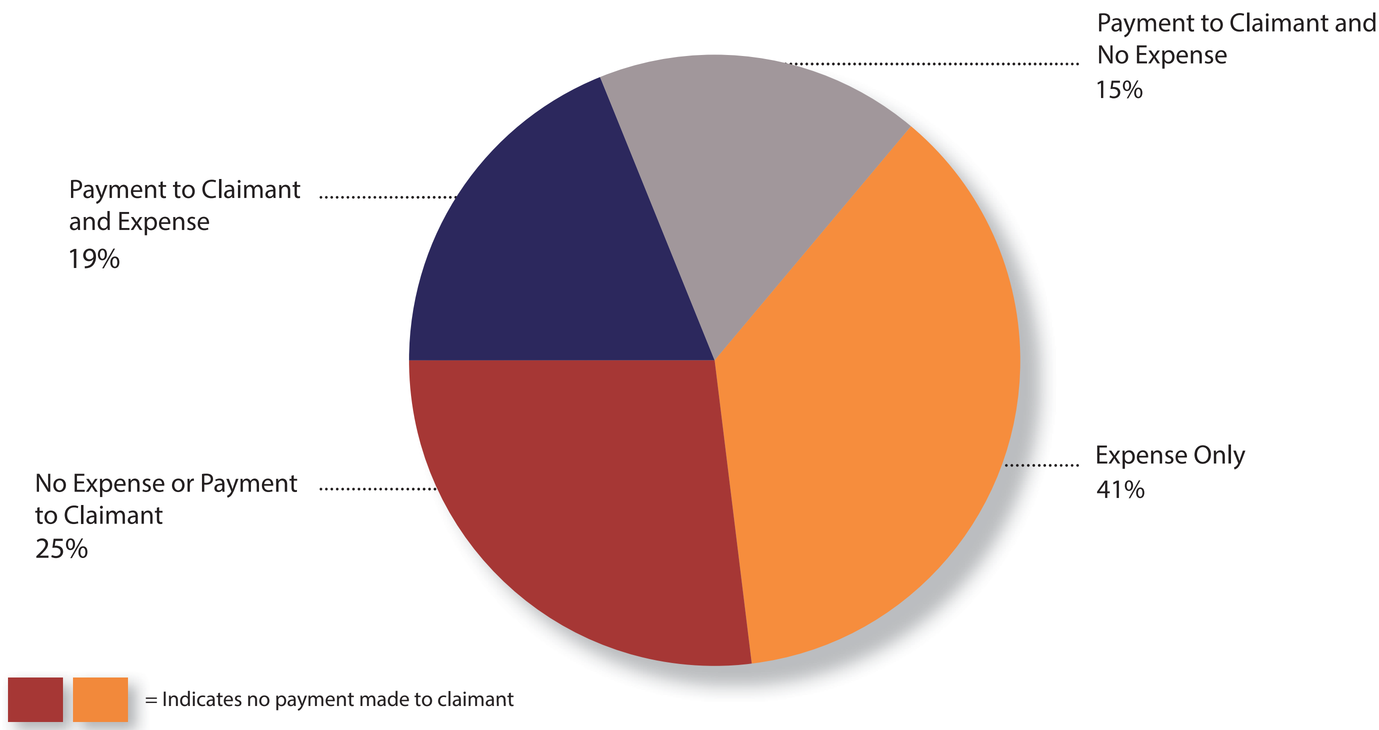
(Primary and Excess Programs Combined)

	12/31/2012	12/31/2011
ASSETS		
Cash and Investments at Market	$35,198,686	$32,717,259
Other Assets	2,705,411	1,284,207
TOTAL ASSETS	**$37,904,097**	**$34,001,466**
LIABILITIES AND FUND EQUITY		
Estimated Liabilities for Claim		
Settlements and Defense Costs	$33,200,000	$34,100,000
Other Liabilities	656,841	682,634
Fund Equity	4,047,256	(781,168)
TOTAL LIABILITIES AND FUND EQUITY	**$37,904,097**	**$34,001,466**

	For the Year Ending December 31	
	2012	2011
REVENUE		
Assessments	$24,803,326	$24,465,415
Investment and Other Income	5,993,767	643,006
TOTAL REVENUE	**$30,797,093**	**$25,108,421**
EXPENSE		
Administrative	$7,495,588	$7,302,307
Provision for Settlements	8,346,373	9,649,812
Provision for Defense Costs	10,126,708	11,286,901
TOTAL EXPENSE	**$25,968,669**	**$28,239,020**
NET INCOME	**$4,828,424**	**($3,130,599)**

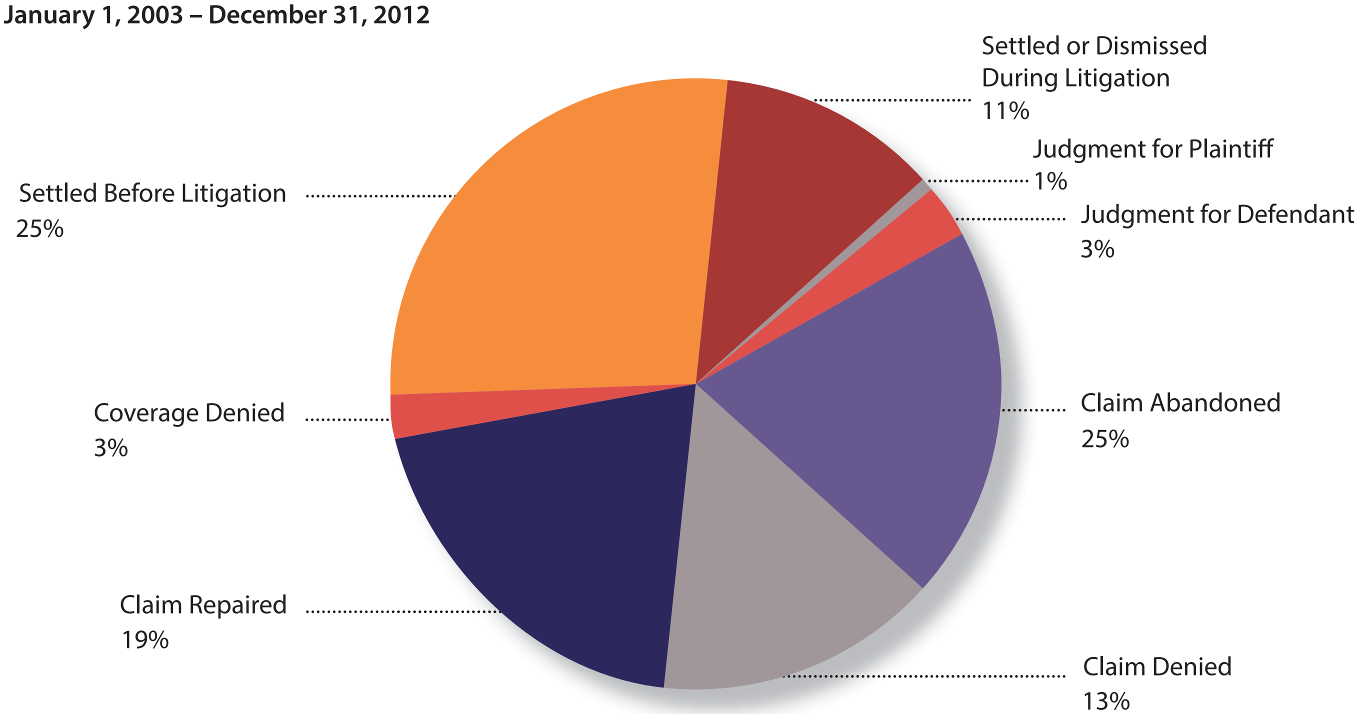
These statements have been adjusted to remove prepaid assessments (e.g., payments of the 2013 assessment received in December of 2012). A complete copy of the December 31, 2011, audit report is available upon request.

Closed Claims
January 1, 2003 – December 31, 2012



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

Disposition of Closed Claims
January 1, 2003 – December 31, 2012



Cost of Claims by Area of Law

January 1, 2003, to December 31, 2012

AREA OF LAW	PERCENT INDEMNITY PAID	INDEMNITY PAID	PERCENT EXPENSES PAID	EXPENSES PAID	TOTAL PAID
Personal Injury	19%	$13,171,196	12%	$7,137,943	$20,309,139
Business Transactions / Commercial Law	13%	9,306,724	18%	10,618,071	19,924,795
Real Estate	16%	11,023,857	14%	8,226,369	19,250,226
Estate Planning & Estate Tax	12%	8,563,664	10%	5,673,475	14,237,139
Bankruptcy & Debtor-Creditor	10%	6,838,643	10%	6,244,126	13,082,769
Domestic Relations / Family Law	9%	6,507,173	9%	5,145,759	11,652,932
Workers' Compensation / Admiralty	4%	2,731,384	1%	838,203	3,569,587
Securities	2%	1,213,508	4%	2,304,957	3,518,465
Criminal	2%	1,642,197	3%	1,737,712	3,379,909
Tax	1%	828,579	3%	1,793,988	2,622,567
Other	12%	8,942,952	16%	10,007,483	18,950,435
	100%	**$70,769,877**	**100%**	**$59,728,086**	**$130,497,963**

Frequency of Closed Claims by Area of Law

January 1, 2003, to December 31, 2012

AREA OF LAW	PERCENT OF CLAIMS	NUMBER OF CLAIMS
Personal Injury	16%	1,306
Domestic Relations / Family Law	16%	1,299
Bankruptcy & Debtor-Creditor	13%	1,018
Real Estate	11%	882
Estate Planning & Estate Tax	10%	840
Business Transactions / Commercial Law	8%	651
Criminal	7%	553
Workers' Compensation / Admiralty	2%	190
Tax	1%	66
Securities	1%	46
Other	15%	1,154
	100%	**8,005**

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of 2013 will remain at $20,000 despite some indications of increased severity during 2012. Maintaining stability in the claim costs is a positive sign. Of special note, claim expenses – which had been steadily increasing in recent actuarial studies – seem to have stabilized.

In summary, the 2012 results saw claim results better than expected, pending claims did not worsen (unlike in past years), and claim frequency has somewhat moderated.

THE 2014 PRIMARY PROGRAM ASSESSMENT

As in other years, four major objectives are considered in the process of setting the assessment. Those objectives are (1) to provide sufficient income to meet the costs of 2014 claims; (2) to provide sufficient income to fully fund the cost of older pending claims; (3) to provide stability to the assessment as long as possible; and (4) to move the PLF toward the goal of providing a reserve to stabilize future assessments.

As the process of determining the 2014 assessment proceeds, the PLF Board's analysis will benefit from the 2012 financial results, as well as from the current positive investment outlook. On the negative side, claim frequency is exceeding projections as of April 1, 2013.

Despite these crosscurrents, the PLF is cautiously optimistic that the assessment will remain unchanged in 2014. The PLF Board recognizes that economic challenges for lawyers and law firms remain, and the Board is committed to making every effort to maintain the assessment at its current rate in 2014. The 2014 assessment will be determined midyear 2013, 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 2012.

The claims-handling evaluation form asks whether covered parties were "satisfied," "very satisfied," or "not satisfied." In 2012, the PLF received 419 responses (45%). 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 just 0.2% "not satisfied" – remarkable numbers. In total, 99.8% of the respondents were "very satisfied" or "satisfied" with the PLF claims attorney's handling of the claim.

Covered parties' satisfaction with defense counsel was also very high. Among the 240 covered parties who responded to the questionnaire about defense counsel, 89.5% were "very satisfied," 8.8% were "satisfied," and 1.7% "not satisfied." (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 responses for claims attorneys and defense counsel totaled 92.4% "very satisfied" and 7.4% "satisfied" – thus 99.8% 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 2012 included programs on data storage security, Portable Document Format, leveraging technology, metadata, maintaining a profitable law office, paper reduction and document management, hints to effectively run a law office, health insurance, retirement, transitions, and compassion fatigue. In addition, the

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PLF continues to offer free audio and video programs (currently 74 programs available), publications (*In Brief* and *In Sight*), over 354 practice aids, and the following handbooks: *Planning Ahead: A Guide to Protecting Your Clients' Interests in the Event of Your Disability or Death* (2011); *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 2012, the PLF presented video replays of the following programs: Data Storage and Professional Responsibility: Understanding Obligations Imposed by New OSB Ethics Opinion 2011-188; Choice of Entity for Contract Lawyers and Sole and Small Firm Practitioners; Increasing Revenue: Updated Strategies for Attracting New Clients and More Effectively Managing an Existing Client Base; What Every Lawyer Needs to Know About Bankruptcy; Riding the Waves of Life in the Law; Metadata: Complying with Oregon Formal Opinion 2011-187; PDFing: A Lawyer's Guide to Adobe Acrobat; Law Office Paper Reduction and Document Management; The Attorney as Employer: Employment and Tax Law Considerations; Recognizing Child Abuse and Fulfilling Your Duty to Report; and Transitions: Challenge or Opportunity? These video replays were presented in Astoria, Bend, Coos Bay, Eugene, Grants Pass, Klamath Falls, Medford, Newport, Pendleton, Redmond, Salem, and Vale, Oregon.

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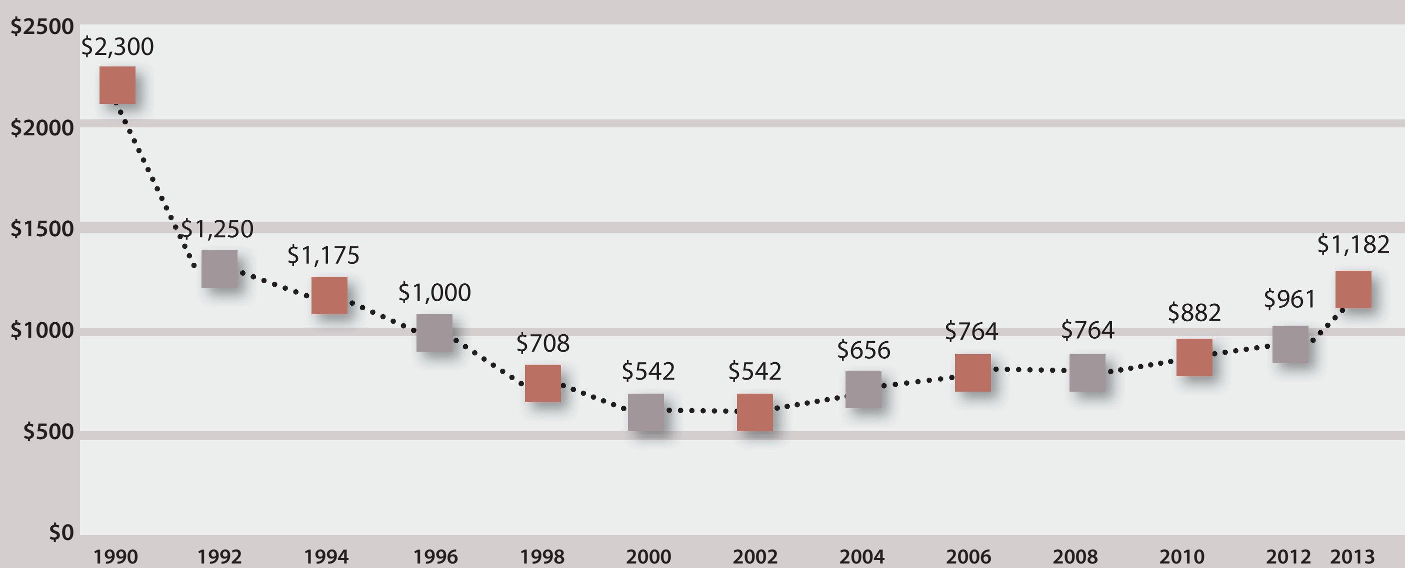
Cost of Excess Coverage – Standard Rates

By Calendar Year 1990 – 2013



Figures are the cost per attorney of $700,000 PLF excess coverage above the primary limits. Figures for 1995 to 2013 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.

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, 100% of those who responded said they would recommend the PLF's PMA services to others. In addition, 100% said they were either "satisfied" or "very satisfied" with reaching a PMA by telephone, amount of time between the request for an appointment and when the appointment took place, the PMA's ability to explain information clearly, how the lawyer was treated by the PMA (patience, courtesy, etc.), helpfulness of the information, follow-up, and overall level of satisfaction with service. In 2012, the PMAs presented seminars all over the state on practice management. In addition to these presentations, the PMAs also provide in-house CLEs for law firms.

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 2012, 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 workshop, a women's support group, a work-life balance workshop for men, a women's wellness retreat, and a group for overcoming procrastination. In addition, the OAAP attorney counselors assisted over 600 lawyers with personal issues in 2012, including alcoholism, drug addiction, career satisfaction, retirement, and mental health issues.

CHANGES TO THE COVERAGE PLAN

In 2012, the PLF Board and the Oregon State Bar (OSB) Board of Governors approved three changes to the 2013 Coverage Plan. (Additions are noted by bold and underscored; deletions are noted by strikethrough.)

The first change was made in Section I.11 to narrow the definition of "LAW ENTITY" to include those engaged in the private practice of law "in Oregon." The purpose of PLF coverage is to protect Oregon attorneys and their firms. This change helps ensure that out-of-state firms without any Oregon presence are not covered.

Section I.11 was revised as follows:

> **11.** "LAW ENTITY" refers to a professional corporation, partnership, limited liability partnership, limited liability company, or sole proprietorship engaged in the private practice of law **<u>in Oregon</u>**.

The second change was made to Exclusion 4 in Section V. That Exclusion addresses coverage for punitive damages and sanctions. Subsection (b) bars coverage for sanctions and penalties levied against covered attorneys and "others." The intent of the use of the term "others" is to bar coverage for clients and parties who might seek indemnity from the lawyer for sanctions or penalties imposed on them for their own conduct. The use of the term "others" in this way is not entirely self-evident and could give rise to confusion about who and what is excluded from coverage under Exclusion 4.

Section V.4.b was revised as follows:

4. This Plan does not apply to:

> **a.** The part of any CLAIM seeking punitive, exemplary or statutorily enhanced damages; or
>
> **b.** Any CLAIM for or arising out of the imposition of attorney fees, costs, fines, penalties, or other sanctions ~~on the COVERED PARTY or others~~ imposed under any federal or state statute, administrative rule, court rule, or case law intended to penalize bad faith conduct and/or the assertion of frivolous or bad faith claims or defenses. The PLF will defend the COVERED PARTY against such a CLAIM, but any liability for indemnity arising from such CLAIM will be excluded.

The third change addresses the issue of when and how a claim is made and coverage is triggered. This is addressed in two separate places in the Coverage Plan: SECTION VII – NOTICE OF CLAIMS and SECTION IV – GRANT OF COVERAGE. Previously, the language was somewhat inconsistent, so Section VII was changed to reconcile the two sections.

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Section VII was revised as follows (additions in italics and bold; deletions noted by strikethrough). Note that Section IV.1 has been included for reference only; no changes were proposed or adopted.

SECTION IV — GRANT OF COVERAGE

1. Indemnity.

a. The PLF will pay those sums that a COVERED PARTY becomes legally obligated to pay as DAMAGES because of CLAIMS arising out of a COVERED ACTIVITY to which this Plan applies. No other obligation or liability to pay sums or perform acts or services is covered unless specifically provided for under Subsection 2 – Defense.

b. This Plan applies only to CLAIMS first made against a COVERED PARTY during the COVERAGE PERIOD.

(1) The applicable COVERAGE PERIOD for a CLAIM will be the earliest of:

(a) When a lawsuit is filed or an arbitration or ADR proceeding is formally initiated; or

(b) When notice of a CLAIM is received by any COVERED PARTY or by the PLF; or

(c) When the PLF first becomes aware of facts or circumstances that reasonably could be expected to be the basis of a CLAIM; or

(d) When a claimant intends to make a CLAIM but defers assertion of the CLAIM for the purpose of obtaining coverage under a later COVERAGE PERIOD and the COVERED PARTY knows or should know that the COVERED ACTIVITY that is the basis of the CLAIM could result in a CLAIM.

(2) Two or more CLAIMS that are SAME OR RELATED CLAIMS, whenever made, will all be deemed to have been first made at the time the earliest such CLAIM was first made. This provision will apply to YOU only if YOU have coverage from any source applicable to the earliest such SAME OR RELATED CLAIM (whether or not the available limits of liability of such prior policy or plan are sufficient to pay any liability or CLAIM.

SECTION VII — NOTICE OF CLAIMS

1. The COVERED PARTY must, as a condition precedent to the right of protection afforded by this coverage, give the PLF, at the address shown in the Declarations, as soon as practicable, written notice of any CLAIM made against the COVERED PARTY. In the event a SUIT is brought against the COVERED PARTY, the COVERED PARTY must immediately notify and deliver to the PLF, at the address shown in the Declarations, every demand, notice, summons, or other process received by the COVERED PARTY or the COVERED PARTY'S representatives.

2. If the COVERED PARTY becomes aware of ~~a specific act, error, or omission~~ ***facts or circumstances that reasonably could be expected to be the basis of a CLAIM*** for which coverage ~~is~~ ***may be*** provided under this Plan ~~during the COVERAGE PERIOD~~, the COVERED PARTY must give written notice to the PLF as soon as practicable during the COVERAGE PERIOD of:

a. The specific act, error, or omission;
b. DAMAGES and any other injury that has resulted or may result; and
c. The circumstances by which the COVERED PARTY first became aware of such act, error, or omission.

~~then any CLAIM that is subsequently made against the COVERED PARTY based on or arising out of such act, error, or omission will be deemed to have been made during the COVERAGE PERIOD.~~

~~3. If, during the COVERAGE PERIOD, a potential claimant requests that the PLF agree to toll or suspend the running of a time limitation applicable to a potential CLAIM against a COVERED PARTY based on a specific act, error, or omission for which coverage is provided under this Plan, and if the PLF agrees in writing to do so with the consent of~~

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~~the COVERED PARTY, then any CLAIM that is subsequently made against the COVERED PARTY based on or arising out of such act, error, or omission will be deemed to have been made during the COVERAGE PERIOD.~~

3. If the PLF opens a suspense or claim file involving a CLAIM or potential CLAIM which otherwise would require notice from the COVERED PARTY under subsection 1. or 2. above, the COVERED PARTY'S obligations under those subsections will be considered satisfied for that CLAIM or potential CLAIM.

COMMENTS

This is a Claims Made Plan. Section IV.1.b determines when a CLAIM is first made for the purpose of triggering coverage under this Plan. Section VII states the COVERED PARTY's obligation to provide the PLF with prompt notice of CLAIMS, SUITS, and potential CLAIMS.

EXCESS PROGRAM

Participation in the PLF Excess Program remains stable. For the 2012 plan year, 715 firms with a total of 2,313 attorneys purchased excess coverage from the PLF.

The most notable change in PLF excess coverage is the addition of the Cyber Liability and Breach Response Endorsement to the 2013 Excess Claims Made Plan. Claims arising from the loss of confidential data are excluded under the terms of both the PLF's primary and excess coverage plans. However, law firms are becoming aware of the potential danger of these claims, and some clients are now requiring firms to have data breach coverage. The new endorsement has been added to address this need.

The new endorsement provides separate coverage limits and terms from the Excess Coverage Plan itself. The coverage is intended to respond to claims arising from any applicable privacy laws or regulations that require the firm to maintain the confidentiality and security of personal information. Coverage under the endorsement addresses both damages and expense associated with a claim, and, perhaps more significantly, it provides for required privacy breach response services. These services can include notification of affected individuals, public notices, credit monitoring, and other crisis management activities required when a privacy breach occurs.

Special coverage for website content liability is also included under the endorsement to address a variety of claims (e.g., defamation, copyright infringement, violations of privacy rights) that may arise from publication of information on the firm's website. Coverage also extends to defense of regulatory actions and any resulting penalties. It is worth noting that the coverage has no deductible and applies not only to confidential information in electronic form but traditional paper files as well.

The PLF Excess Program continues to be entirely reinsured and financially independent from the mandatory PLF Primary Coverage Program. We continue to offer accumulating continuity credit discounts of 2% per year (up to 20%).

CHANGES IN PLF BYLAWS AND POLICIES

No changes were made to the 2012 PLF Bylaws. Several changes were made to the 2012 PLF Policies effective January 1, 2013.

Policy 3.150(G)(10) Government Activity Exemption:

Policy 3.150 *et. seq.* specifies exemptions from PLF coverage. Policy 3.150(G)(10) provides that attorneys whose sole employment is on behalf of a public entity are exempt from PLF coverage if their work "comes within the defense and indemnity of requirements of ORS 30.285 and 30.287, or similar state or federal statutes, rule or case law." Those statutes indemnify employees of government agencies. The new wording clarifies the scope of the exemption.

Policy 3.450 PAYMENTS MADE IN ERROR.

Under PLF Policies, when a payment is made in error to the PLF by an attorney who is exempt from PLF coverage, refunds are available at the discretion of the PLF CEO. These refunds are regularly approved. The revision to Policy 3.450 limits the period of time for which refunds will be made to no more than two years. Under previous wording, refunds were available for a longer period.

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Policy 3.500(B)(1) Special Underwriting Assessment:

PLF Policy 3.500 outlines the calculation of the Special Underwriting Assessment (SUA). SUA is a charge of 1% of the amount exceeding a $75,000 "safe harbor" the PLF pays on behalf of a covered party in settling or defending a claim. The 1% is charged for each of the five years after the claim is closed.

In some instances, when two claims are based on the same subject matter but are brought against two or more covered parties, those covered parties may share a single PLF primary limit. Prior to the revision in 3.500(B)(1), the $75,000 safe harbor was applicable to the group of related claims. Under the new provision, each covered party sharing a limit will receive his or her own $75,000 safe harbor before a SUA will accrue.

Other editorial and style changes were made to the PLF policies that do not affect coverage and, as such, are not discussed here.

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 – a small percentage of the total budget – can be predicted with certainty. At the current time, claim frequency is higher than predicted, and it is too early to predict other trends. The final decision on the 2014 assessment will be made in August 2013, after additional information about claim performance is available.

Over the past several years, a number of experienced PLF staff have retired, and additional retirements are expected in the next several years. In response, the PLF has devoted significant energy and thought to succession issues. That work will ensure that the highest standards of claim representation, practice management assistance, and OAAP assistance will be maintained.

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

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Oregon State Bar PROFESSIONAL LIABILITY FUND
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