K&L GATES

Professional Liability Alert

November 2008 www.klgates.com

Authors:

Paul M. Koning
+1.214.939.5564
paul.koning@klgates.com

Brent E. Basden
+1.214.939.5805
brent.basden@klgates.com

Legal Malpractice Arbitration Agreements: The Rules of the Road in Texas

The State Bar of Texas and other state bars encourage binding arbitration of fee disputes. There has been more controversy, however, as to whether Texas lawyers may include in their engagement letters binding arbitration provisions that encompass client malpractice claims. In Ethics Opinion No. 586, the Professional Ethics Committee for the State Bar of Texas (the "Committee") concludes that such provisions are ethically permissible under the Texas Disciplinary Rules of Professional Conduct (the "Rules"), so long as the lawyer adequately discloses to the client the advantages and disadvantages of arbitration.

Although the Rules do not mention malpractice arbitration agreements, Rule 1.08(g) prohibits a lawyer from prospectively agreeing with a client to limit the lawyer's malpractice liability unless (1) the agreement is permitted by law and (2) the client is represented by independent counsel with respect to the agreement. The Committee agrees with the American Bar Association Standing Committee on Ethics and Professional Responsibility that arbitration of malpractice claims does not limit a lawyer's liability, but instead creates a procedure for resolving client claims. *See* ABA Opinion 02-425. Arbitration does not enable a lawyer to escape malpractice liability, but simply vests resolution of the claim in an arbiter or arbitration panel, rather than a court of law.

The Committee notes that malpractice arbitration agreements may not run afoul of a Texas lawyer's duty to be fair and reasonable in dealings with clients. *See* Rule 1.08, comment 2 ("As a general principle, all transactions between client and lawyer should be fair and reasonable to the client."). A lawyer may not include unfair or onerous terms in the arbitration provision, such as granting the lawyer the sole right to select the arbiter, requiring arbitration in a remote location, or imposing excessive costs that would impede a client's ability to arbitrate a claim. Unfair terms would also violate Rule 1.08(g)'s prohibition against prospective limitations of lawyer liability.

As a safeguard for clients, the Committee also requires the lawyer to make certain disclosures about the advantages and disadvantages of arbitration. These disclosures allow the client to make an informed decision whether to agree to binding arbitration. The Committee explains that the level of disclosure will vary depending on the sophistication of the client and entrusts the scope of the explanation to the lawyer's reasonable judgment.

Typically, the lawyer should advise the client of the following differences between arbitration and litigation: (1) the cost and time savings associated with arbitration; (2) the waiver of significant rights, such as a jury trial; (3) the possible reduced level of discovery; (4) the relaxation of evidentiary rules; and (5) the loss of the right to judicial appeal. Other possible topics include (1) the privacy of arbitration, as compared to trial; (2) the method of selecting arbitrators; and (3) the client's obligation to pay some or all of the fees and costs of arbitration.

Finally, the Committee notes that at least one Texas appellate court has held that a malpractice claim is a "personal injury" claim, which could pose a potential obstacle to malpractice arbitration agreements. *See In re Godt*, 28 S.W.3d 732, 738-39 (Tex. App.—Corpus Christi 2000, orig. proceeding). An agreement to arbitrate a personal injury claim is not enforceable under the Texas Arbitration Act unless the parties to the arbitration agreement are represented by separate counsel and the parties and their counsel sign the agreement. However, the Texas appellate courts have split on the issue of whether a malpractice claim is a personal injury claim requiring compliance with the Texas Arbitration Act. *Compare Taylor v. Wilson*, 180 S.W.3d 627, 629-31 (Tex. App.—Houston [14th Dist.] 2005, pet. denied); *In re Hartigan,* 107 S.W.3d 684, 689-91 (Tex. App.—San Antonio, orig. proceeding [mand. denied]) *with In re Godt*, 28 S.W.3d at 738-39.

What the Committee did not address is whether malpractice arbitration clauses are really in the *law firm's* best interest. In our experience, and in the experience of many insurers, law firm defendants are generally better off avoiding arbitration. Law firm defendants are particularly disadvantaged by the apparent flexibility with which arbitrators may disregard bright-line legal defenses such as limitations, privity and causation. The lack of appellate review only compounds this disadvantage. The promise that arbitration will always result in cost savings has proven to be somewhat of a myth, and neither the hope of cost savings nor the benefit of confidentiality outweighs the procedural and legal disadvantages of arbitrating the legal malpractice case. Even though Opinion 586 allows it, a law firm should deliberate very carefully before including a malpractice arbitration provision in its engagement letters.