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PREPAID LEGAL SERVICES: A NEW FRONTIER

I. INTRODUCTION

During its 1978 regular session, the Virginia General Assembly continued its efforts to regulate prepaid legal services. Enacted was a bill designed to regulate certain legal services plans not covered by Virginia or federal statute.¹

Virginia law has regulated legal services insurance, or indemnification for legal expenses, as any other form of insurance since 1976.² The new law will allow plans which provide services, as opposed to indemnity, to organize under a less stringent system modeled after the Blue Cross-Blue Shield approach.³ The General Assembly rejected the approach of the Model Act proposed by the National Association of Insurance Commissioners. That scheme includes both indemnity and service contracts in its definition of legal services insurance, both of which are subjected to less stringent controls than other insurance. Only one state has adopted the Model Act.⁴

1. An Act of Assembly of March 9, 1976, 1976 Va. Acts c.658 (codified in VA. CODE ANN. §§ 38.1-22.1, 38.1-790 to -809, 58-490 (Cum. Supp. 1978)), hereinafter referred to as the Act. The bill was sponsored by Senator J. Harry Michael of Charlottesville, Virginia. Regulation under the new law will be through the State Corporation Commission and the Insurance Commissioner.

2. Legal services insurance, regulated under VA. CODE ANN. § 38.1-389.4 (Repl. Vol. 1976), is defined in 38.1-22.1 (Cum. Supp. 1978) as:

. . . the assumption of a contractual obligation to reimburse the insured against, or pay on behalf of the insured, all or a portion of his fees, costs, and expenses related to or arising out of service performed by or under the supervision of an attorney licensed to practice in the jurisdiction where in said services are performed.

3. Legal services plan is defined in VA. CODE ANN. § 38.1-791(2) (Cum. Supp. 1978) as:

. . . the assumption of a contractual obligation or an arrangement, whereby legal services are provided in consideration of a specified payment regardless of whether such payment is made by the subscribers individually or by a third person for them.

The provisions on contracts for future hospitalization and medical and related services are found in VA. CODE ANN. § 32-195.1 *et seq.* (Rep. Vol. 1973). These provisions originally came into the Virginia law as an Act of Assembly of March 16, 1940, 1940 Va. Acts c. 230, and have been amended and recodified into their present form.

Legal services plans will encompass both group and individual contracts as has been said in the case with medical service plans. 1975 VA. ATT'Y GEN. OP. 314.

4. N.A.I.C. Prepaid Legal Expense Insurance Model Act (adopted in 1974) printed in 2 OFFICIAL N.A.I.C. MODEL INSURANCE LAWS, REGULATIONS AND GUIDELINES 680-1, -13 & -14 (1977) [hereinafter cited as the MODEL ACT].

Although the MODEL ACT was not adopted, several portions of it concerning the purposes and scope of the law were adapted to the Virginia Act. The state adopting the MODEL ACT was Arkansas.

II. PROVISIONS OF THE ACT

Among the stated purposes of the Act are: to encourage development of effective and economic ways of providing legal services and to ease the financial burden on the consumer;⁵ to provide a flexible regulatory framework for experimentation with new forms of delivery systems;⁶ and to place the risk of such experimentation on promoters rather than the consumer.⁷

The Act allows any group of attorneys or any person or group of persons to conduct a legal services plan either directly or through an agent.⁸ Participants are to be jointly and severally liable on all contracts made on behalf of the plan.⁹ As a condition to licensing, a plan must demonstrate ability to meet its obligations to all subscribers based on its financial condition and method of doing business.¹⁰

Explicitly excluded from regulation are retainer contracts;¹¹ referral services;¹² plans providing for limited benefits on simple matters in the context of an employment, educational, or similar relationship and not involving a legally binding promise;¹³ services provided by employee organizations in matters relating to employment;¹⁴ services provided by any

5. VA. CODE ANN. § 38.1-790(1) (Cum. Supp. 1978). Source: MODEL ACT §§ 1 (1) & (2), note 4 *supra*.

6. VA. CODE ANN. § 38.1-790(2) (Cum. Supp. 1978). Source: MODEL ACT § 1 (2), note 4 *supra*.

7. VA. CODE ANN. § 38.1-790(3) (Cum. Supp. 1978). Source: MODEL ACT § 1 (3), note 4 *supra*.

8. VA. CODE ANN. §§ 38.1-792 & -793 (Cum. Supp. 1978). Source: *Id.* 32-195.2 (Repl. Vol. 1973) & -195.3:1 (Cum. Supp. 1978). The provision for non-stock corporate operation appearing in the source sections does not appear in the Act.

9. VA. CODE ANN. § 38.1-794 (Cum. Supp. 1978). The section also provides that a contract executed by the agent alone is binding upon the principals, that an action on such a contract may be brought by naming the agent as the sole defendant, and that ". . . a judgment in favor of the plaintiff may be satisfied out of the assets of the plan in the custody of the agent or out of the asset of each and all of the principals." Source: *Id.* § 32-195.4 (Repl. Vol. 1973). It is also provided that any participating person or attorney may resign from the plan and remain liable on any subscription contract while effective, but not beyond the current contract years. *Id.* § 38.1-795 (Cum. Supp. 1978). Persons and attorneys may be admitted to participation in a plan at any time and will automatically become liable on all outstanding contracts. *Id.* Source: *Id.* § 32-195.5 (Repl. Vol. 1973).

10. *Id.* § 38.1-802 (Cum. Supp. 1978). The source is *Id.* § 32-195.11 (Repl. Vol. 1973), but that section does not contain the requirement set out in the text.

11. *Id.* § 38.1-802 (1) (Cum. Supp. 1978). Source: MODEL ACT § 2 (4) (b) (i), note 4 *supra*.

12. VA. CODE ANN. § 38.1-802 (2) (Cum. Supp. 1978). Source: MODEL ACT § 2 (4) (b) (ii), note 4 *supra*.

13. VA. CODE ANN. § 38.1-802 (3) (Cum. Supp. 1978). Source: MODEL ACT § 2 (4) (b) (iii), note 4 *supra*. This section exempts a university, for example, that employs an attorney to advise students as the need arises.

14. VA. CODE ANN. § 38.1-802 (4) (Cum. Supp. 1978). Source: MODEL ACT § 2 (4) (b) (iv),

government agency to its employees;¹⁵ legal services insurance;¹⁶ and the furnishing of legal assistance by "organizations or organizations of employees" where the organization contracts directly with the attorney for the provision of legal services.¹⁷

The Act makes various provisions of the insurance title of the Virginia Code applicable to legal services plans, including the unfair trade practices and antitrust provisions.¹⁸ Plans are prohibited from making payments to subscribers except for damages due to breach of contract or for compensation if services are rendered by a nonparticipating attorney.¹⁹ Plans are also prohibited from using any misleading advertising matter, subscription applications, or contracts—whether written or oral.²⁰

The Act creates a regulatory framework which includes reporting²¹ and disclosure provisions.²² If a plan is operated in corporate form by a group

note 4 *supra*. This has been characterized as the "typical union lawyer arrangement." April 1978 VA. B. NEWS at 22.

15. VA. CODE ANN. § 38.1-802 (5) (Cum. Supp. 1978). Source: MODEL ACT § 2 (4) (b) (v), note 4 *supra*.

16. VA. CODE ANN. § 38.1-802 (6) (Cum. Supp. 1978). Source: New. See note 2 *supra*, for the definition of legal services insurance.

17. VA. CODE ANN. § 38.1-802 (7) (Cum. Supp. 1978). Source: New. There are said to be approximately twelve union plans with the direct retainer contract feature operating in Virginia at present. April 1978 VA. B. NEWS at 23.

18. VA. CODE ANN. § 38.1-798 (Cum. Supp. 1978). Source: *Id.* § 32-195.8 (Cum. Supp. 1978). The unfair trade practices and antitrust provisions are codified in *Id.* §§ 38.1-49 to -62 (Repl. Vol. 1976 & Cum. Supp. 1978). The Act also makes the following sections of title 38.1 applicable to legal services plans: the general powers of the SCC to regulate insurance (§ 38.1-29 (Repl. Vol. 1976)); provisions requiring SCC approval for management and exclusive agency contracts (§ 38.1-29.1 (Repl. Vol. 1976)); provisions relating to assessments for administration of insurance laws (§§ 38.1-44 to -48 (Repl. Vol. 1976 & Cum. Supp. 1978)); the Unauthorized Insurers Process Act (§§ 38.1-63 to -70 (Repl. Vol. 1976)); provisions relating to refusal, suspension or revocation of licenses (§§ 38.1-99 to -104 (Repl. Vol. 1976)); provisions pertaining to annual statements and other reports (§§ 38.1-159 to -165 (Repl. Vol. 1976)); provisions on examination (§§ 38.1-174 to -178 (Repl. Vol. 1976 & Cum. Supp. 1978)); and the requirement that policy forms be filed with and approved by the SCC (§ 38.1-342.1 (Cum. Supp. 1978)). Also made applicable to the plans were sections of title 58 levying a license tax on (§ 58-490 (Cum. Supp. 1978)) and requiring declarations of estimated income tax by insurance companies (§ 58-502.1 *et seq.* (Repl. Vol. 1974)).

19. *Id.* § 38.1-798 (Cum. Supp. 1978). Source: *Id.* § 32-195.8 (Cum. Supp. 1978).

20. *Id.* § 38.1-805 (Cum. Supp. 1978). Source: *Id.* § 32-195.16 (Repl. Vol. 1973).

21. *Id.* § 38.1-799 (Cum. Supp. 1978). Source: *Id.* § 32-195.8:1 (Repl. Vol. 1973).

22. *Id.* § 38.1-801 (Cum. Supp. 1978). Source: *Id.* § 32-195.8:3 (Repl. Vol. 1973). There are provisions on licensing of plans and salesmen, *Id.* §§ 38.1-802 to -804 (Cum. Supp. 1978), powers of the State Corporation Commission, *Id.* §§ 38.1-806 & -807, and appeals from the SCC to the Virginia Supreme Court, *Id.* § 38.1-808. The jurisdiction of the SCC does not extend to controversies growing out of subscription contracts. *Id.* § 38.1-809. Source: *Id.* § 32-195.20 (Repl. Vol. 1973).

of attorneys, a majority of the board of directors must be providers of legal services.²³ If the corporation is operated by other than a group of attorneys, then a majority of the board of directors must be subscribers who are not providers of legal services or employees or officers of the plan.²⁴ In addition, the subscriber must be afforded free choice of the attorneys available and participating in the plan.²⁵

III. THE FIRST AMENDMENT AND THE ETHICS CODE

The growth of prepaid legal services was stipulated in the 1960's by three decisions of the United States Supreme Court. In *NAACP v. Button*,²⁶ the NAACP was held entitled to an injunction restraining enforcement of Virginia's unlawful solicitation statute prohibiting acceptance of employment from anyone not a party to, or who had no pecuniary right or liability in, a judicial proceeding.²⁷ Thus, a nonprofit organization, which did not have as its primary purpose the furnishing of legal services, could under first amendment freedom of association principles, select and compensate counsel to bring suits for individuals challenging racial discrimination in violation of their federal constitutional rights.²⁸

In *Brotherhood of Railroad Trainmen v. Virginia*,²⁹ the Court held that the Virginia State Bar could not condemn, as unauthorized practice or unlawful solicitation, the BRT's plan in which members and their families were assisted by union counsel in finding an attorney in certain work-related accident cases.³⁰

Finally, in *United Mine Workers v. Illinois Bar Association*,³¹ it was held that the UMW's retaining of an attorney to bring workmen's compensation cases could not be enjoined as unauthorized practice of law.³²

23. *Id.* § 38.1-797 (Cum. Supp. 1978). Source: *Id.* § 32-195.5:2 (Cum. Sup. 1978).

24. *Id.* § 38.1-796 (Cum. Supp. 1978). Source: *Id.* § 32-195.5:1 (Cum. Supp. 1978).

25. *Id.* § 38.1-800 (Cum. Supp. 1978). Source: *Id.* § 32-195.8:2 (Repl. Vol. 1973). See notes 54-71 & 98-112, *infra*, and corresponding text. The definition of legal services insurance was also amended to eliminate the requirement that the attorney be selected "solely by said insured." VA. CODE ANN. § 38.1-22.1 (Cum. Supp. 1978). See note 2 *supra*.

26. 371 U.S. 415 (1963).

27. Wilcox & Schneider, *Prepaid Legal Services and the Code of Professional Responsibility*, 36 OHIO ST. L.J. 761, 765-66 (1975); [hereinafter cited as WILCOX & SCHNEIDER]; Emmons, *United States ex parte Group Legal Plans v. Code of Professional Responsibility: Have Ethical Considerations Finally Won Over the Disciplinary Rules?*, 44 INS. COUNSEL J. 248, 249 (1977); [hereinafter cited as EMMONS]. As Mr. Emmons notes, many articles touching this subject have summaries of these cases. *Id.* at n. 16.

28. WILCOX & SCHNEIDER, note 27 *supra*, at 765-66; EMMONS, note 27 *supra*, at 249.

29. 377 U.S. 1 (1964).

30. WILCOX & SCHNEIDER, note 27 *supra*, at 766; EMMONS, note 27 *supra*, at 249.

31. 389 U.S. 217 (1967).

32. WILCOX & SCHNEIDER, note 27 *supra*, at 766-67; EMMONS, note 27 *supra*, at 249.

Throughout this line of cases, the Court recognized that the state does have a legitimate interest in regulating the practice of law. However, this interest must be balanced against first amendment principles, for the state, “. . . apparently cannot prohibit the right (of a group) to organize with respect to providing legal services to its members by claiming that the client's interest *might* be sacrificed or that the profession *might* be injured.”³³ A definite injury must be shown.³⁴

The response of the national bar to these cases came in 1969 with the adoption by the American Bar Association of its Code of Professional Responsibility. The Disciplinary Rules provided that an attorney could assist only those legal services organizations which were nonprofit and whose primary purpose did not include rendering legal services. Furthermore, the rules required that the organization receive no financial benefit from the rendering of services which were required to be incident to the organization's primary purpose.³⁵ The ABA made its position perfectly clear when it provided that an attorney could assist such an organization “. . . only in those instances and to the extent that controlling constitutional interpretation at the time of the rendition of the services requires the allowance of such legal service activity. . . .”³⁶

The Virginia State Bar supported this narrow reading of the previously discussed cases and recommended adoption of the rule.³⁷ The rule was adopted in 1970 by the Virginia Supreme Court in the same form as originally promulgated by the ABA.³⁸

In 1971, the United States Supreme Court decided *United Transportation Union v. State Bar of Michigan*.³⁹ As in *BRT*, the activity sought to be prohibited involved recommending attorneys to members and their families.⁴⁰ In *UTU*, however, the union had agreements with the attorneys regarding maximum fees.⁴¹ In reversing the Michigan Supreme Court, Mr.

33. WILCOX & SCHNEIDER, note 27 *supra*, at 767 (emphasis in original).

34. *Id.*

35. ABA CODE OF PROFESSIONAL RESPONSIBILITY D.R. 2-103 (D) (4) (1969) [hereinafter cited as 1969 ABA D.R.].

36. *Id.*

37. Report of Committee on Group Legal Services, May 1970 VA. B. NEWS at 8.

38. Order amending VA. SUPP. CT. R. 6:II, 211 Va. 295 (1970). The order repealed the Cannons of Professional Ethics and substituted the Code of Professional Responsibility. The particular rule in question became VA. SUP. CT. R. 6:II:D.R. 2-103 (D) (5), 211 Va. 295, 310-11 (1970), [hereinafter cited as 1970 VA. D.R.].

39. 401 U.S. 576 (1971).

40. See notes 29 & 30, *supra*.

41. WILCOX & SCHNEIDER, note 27 *supra*, at 767; EMMONS, note 27 *supra* at 249.

Justice Black, speaking for the Court, noted that the earlier case had been read too restrictively.⁴² He then addressed the scope of the evolving right:

The principal here involved cannot be limited to the facts of this case. At issue is the basic right to group legal action. . . . The common thread running through our decisions (in the earlier cases) is that collective activity undertaken to obtain meaningful access to the courts is a fundamental right within the protection of the First Amendment. However, the right would be a hollow promise if courts could deny associations of workers or others the means of enabling their members to meet the costs of legal representation.⁴³

It became apparent that the Supreme Court was balancing the interest of the public against that of the profession.⁴⁴ In other words, the public has a fundamental right under the first amendment to organize in meeting the cost of legal assistance.⁴⁵ To burden this right, the state must show a "substantial regulatory interest"⁴⁶ or a "substantive evil" endangering professional standards.⁴⁷ The state interest must be compelling⁴⁸ and not merely theoretical or imaginable.⁴⁹

United Transportation Union generated discussion in the Virginia State Bar.⁵⁰ The Bar recommended that the Disciplinary Rules be amended to allow attorney participation in prepaid legal services plans and to provide adequate safeguards for both the public and the Bar.⁵¹ It also recommended that the Bar takes steps to sponsor an open panel plan.⁵² Accordingly, an amendment was offered and approved.⁵³

42. *UTU v. State Bar of Michigan*, 401 U.S. 576, 579-80 (1971).

43. *Id.* at 585-586.

44. *WILCOX & SCHNEIDER*, note 27 *supra*, at 768; *EMMONS*, note 27 *supra*, at 249-50.

45. See note 43, *supra*.

46. *EMMONS*, note 27 *supra*, at 250.

47. *WILCOX & SCHNEIDER*, note 27 *supra*, at 768.

48. *NAACP v. Button*, 371 U.S. 415, 439 (1963).

49. *EMMONS*, note 27 *supra*, at 450. See text corresponding to note 33, *supra*.

50. See, Howard W. Dobbins, *Prepaid Legal Services: Developments and Proposals*, Nov.-Dec. 1972 VA. B. NEWS at 15. Mr. Dobbins, then Chairman of the Virginia State Bar Prepaid Legal Services Committee, noted that the Bar was not participating in this rapidly expanding area. *Id.* at 15-16. He went on to summarize the Supreme Court cases with particular emphasis on the language of Mr. Justice Black (see text corresponding to note 43, *supra*). *Id.* at 18. He noted that prepaid legal services plans would tap a previously unserved group of potential clients and posed the question why legal services plans should be regulated differently than medical services plans. *Id.* at 19.

51. Report of Committee on Prepaid Legal Services, May-June 1973 VA. B. NEWS at 27.

52. *Id.*

53. The proposed amendment to VA. SUP. CT. R. 6:II:D.R. 2-103 (D) was printed in Nov.-Dec. 1973 VA. B. NEWS at 16. The amendment was adopted by the Virginia Supreme Court (Order amending VA. SUP. CT. R. 6:II:D.R. 2-103 (D), 215 Va. 246 (1974)) with minor changes supported by both the Virginia State Bar and the Virginia Bar Association. Report of the Committee on Legal Ethics and Professional Responsibility, Jan. 1975 VA. B.A.J. at 35. The

The amendment deleted the "controlling constitutional interpretation" language from the 1970 version, and substituted a requirement that the organization be collectively established.⁵⁴ It further provided that the organization may derive a financial benefit if the lawyer renders services to the organization as a whole.⁵⁵ Also, the emphasis on the attorney maintaining his independent judgement was strengthened.⁵⁶

In addition to modifying the existing rule, a second class of plans was created in which attorneys would be allowed to participate.⁵⁷ Under this rule, an attorney could assist any open panel plan which did not derive a profit except an actuarial one derived from the overall operation of the plan.⁵⁸

Meanwhile, the ABA had adopted the Houston Amendments to the rules regulating legal services plans.⁵⁹ While authorizing both open and closed panels, the effect of these amendments was to restrict closed panels in favor of open panels.⁶⁰ Like the previous rule, a closed panel had to be non-profit and could not have the provision of legal services as one of its primary purposes.⁶¹ The amendments were criticized for unduly restricting closed panels in the dissemination and cost of services.⁶² The closed panel

entire rules of the Virginia Supreme Court are printed in 216 Va. 941 (1976). The amended portions of the rule are hereinafter cited as 1974 VA. D.R.

54. 1974 VA. D.R. 2-103 (D) (5), n. 5 *supra*. See, notes 35-38, *supra*, and corresponding text.

55. 1974 VA. D.R. 2-103 (D) (5) (c).

56. *Id.* at 2-103 (D) (5) (c) & (d). There are reporting and disclosure provisions applicable to the plan. *Id.* at 2-103 (D) (5) (g) & (e). The participating attorney must file an affidavit of compliance with these rules in the office of the Executive Director of the Virginia State Bar. *Id.* at 2-103 (D) (5) (j).

In addition, there are anti-solicitation and anti-publicity provisions applicable to the participating attorney. *Id.* at 2-103 (D) (5) (i) & (f).

Plans are also prohibited from using subscribers' contributions for purposes other than providing legal services and from allowing unlicensed persons to practice law. *Id.* at 2-103 (D) (5) (c) & (h).

57. *Id.* at 2-103 (D) (6).

58. *Id.* at 2-103 (D) (6) & (D) (6) (b). This provision has rules similar to those in 1974 VA. D.R. 2-103 (D) (5), note 56 *supra*, on the maintenance of independent professional judgment, disclosure, reporting, anti-solicitation, anti-publicity, and unauthorized practice. *Id.* at 2-103 (D) (6) (a) & (c)-(g).

59. Young, *House of Delegates Acts on Group Legal Services, Shield Legislation, Court Organization Standards, and Uniform Divorce*, 60 A.B.A.J. 446 (1974). The pertinent changes to D.R. 2-103 (D) appear in this article. *Id.* at 448 [hereinafter cited as 1974 ABA D.R.].

60. *Id.*; Note, *Prepaid Legal Services, Ethical Codes, and the Snares of Antitrust*, 26 SYRACUSE L. REV. 754, 758 (1975) [hereinafter cited as SYRACUSE NOTE]; WILCOX & SCHNEIDER, note 27 *supra*, at 772-73.

61. 1974 ABA D.R. 2-103 (D) (5) (a) (i)-(iii), note 59 *supra*. See notes 35-38, *supra*, and corresponding text.

62. Remarks of Thomas E. Kauper, Ass't. Att'y Gen., Anti-Trust Division to the National

concept was severely limited by a provision requiring that the subscriber have the free choice of any attorney outside the plan and that the plan reimburse the subscriber for the use of such an attorney.⁶³ These restrictions on closed panel plans were assailed as anticompetitive practices⁶⁴ and as unconstitutional restraints on first amendment rights.⁶⁵ This debate led to a subsequent revision of the rules when the Chicago Amendments were adopted in 1975.⁶⁶

Under the Chicago Amendments, the organization may be either profit or non-profit, provided that if it is organized for profit, ". . . services may not be rendered by lawyers employed, directed, supervised or selected by it. . . ." ⁶⁷ The provision providing that the primary purposes of the organization could not include the provision of legal services was eliminated.⁶⁸ A plan may not be organized for the primary purpose of providing financial, or other, benefits to the lawyer, and may not be operated to procure clients for the lawyer outside of the service plan.⁶⁹

Additionally, the amendments provide that the member or beneficiary may choose counsel other than that furnished, selected, or approved by the plan, but the mandatory reimbursement provision was dropped.⁷⁰ In its stead is a provision requiring that the plan provide appropriate relief for claims that representation by counsel (which the plan has furnished, se-

Conference of Bar Presidents, reprinted in *Justice Department Continues its Contentions that the Houston Amendments Raise Serious Antitrust Problems*, 60 A.B.A.J. 1410, 1411 (1974) [hereinafter cited as ANTITRUST PROBLEMS].

63. 1974 ABA D.R. 2-103 (D) (5) (a) (v), note 59 *supra*. The "prevailing constitutional interpretation" language of 1969 ABA D.R. 2-103 (d) (4), note 35, *supra*, was retained in 1974 ABA D.R. 2-103 (D) (5) (a) (ix), note 59, *supra*, as an exception to the rule stated in the text. See note 36, *supra*, and accompanying text.

64. *Justice Department and Other Views on Prepaid Legal Services Plans Get an Airing Before the Tunney Subcommittee*, 60 A.B.A.J. 791 (1974) (Remarks of Bruce B. Wilson, Deputy Ass't. Att'y Gen., Anti-Trust Division) [hereinafter cited as TUNNEY SUBCOMMITTEE]; ANTITRUST PROBLEMS note 62 *supra*. See notes 98-118, *infra*, and accompanying text.

65. TUNNEY SUBCOMMITTEE, note 64 *supra* (Remarks of F. William McCalpin, a former Chairman of the ABA Committee on Prepaid Legal Services).

66. ABA CODE OF PROFESSIONAL RESPONSIBILITY D.R. 2-103 (D) (4) (1975), hereinafter cited as 1975 ABA D.R. For a more detailed treatment of the shift from the 1974 version to the 1975 version, see Comment, *Group Legal Services: From Houston to Chicago*, 79 DICKINSON L. REV. 621 (1975).

67. 1975 ABA D.R. 2-103 (D) (4) (a), note 66 *supra*. An exception to this rule is made where the ultimate liability is on the organization such as insurers defending insureds on liability claims. *Id.*; EMMONS, note 47 *supra*, at 252.

68. 1975 ABA D.R. 2-103 (D) (4), note 66 *supra*. See notes 35 & 61, *supra*, and corresponding text.

69. 1975 ABA D.R. 2-103 (D) (4) (b) & (4) (c), note 66 *supra*.

70. *Id.* at D.R. 2-103 (D) (4) (e).

lected, or approved) would be unethical, improper, or inadequate under the circumstances.⁷¹

IV. FEDERAL LEGISLATION

Congress has also enacted legislation designed to spur development of legal services plans. In 1973, the Taft-Hartley Act was amended to allow unions to negotiate directly with employers for legal services plans as fringe benefits.⁷² The Internal Revenue Code of 1954 was also modified to offer employers a deduction for contributions to qualified plans,⁷³ to exclude both plan-paid benefits and employer contributions from employee gross income,⁷⁴ and to give the trust funds of such plans tax-exempt status.⁷⁵ The 17.5 million dollar United Auto Workers-Chrysler Corporation closed panel plan was recently the first plan approved by the Internal Revenue Service under the new law.⁷⁶

Further congressional initiative is seen in the Employment Retirement Income Security Act of 1974,⁷⁷ which governs "employee benefit plans" established or maintained by any employer, employee organization, or by both.⁷⁸ "Employee benefit plan" includes "employee welfare benefit plans,"⁷⁹ which are programs providing, through the purchase of insurance or otherwise, prepaid legal services among other benefits.⁸⁰

ERISA provides that it supersedes any and all state laws as they relate

71. *Id.* See note 63, *supra*, and accompanying text.

72. 29 U.S.C.A. 186 (c) (8) (1965-75 Pamph. Supp.); EMMONS n. 2, *supra*, at 250; Bartosic & Bernstein, *Group Legal Services as a Fringe Benefit: Lawyers for Forgotten Clients Through Collective Bargaining*, 59 VA. L. REV. 410, 444-49 (1973).

Under these amendments to the Taft-Hartley Act, the group is free to decide whether it wants an open or closed panel. Bernstein & DeMent, *Recent Developments in Prepaid Legal Services*, 34 FED. B. J. 72 (1975) [hereinafter cited as BERNSTEIN & DEMENT].

73. I.R.C. § 162 (a); Treas. Reg. § 1.162-10.

74. I.R.C. § 120.

75. I.R.C. § 501 (c) (20). Such plans will be governed by ERISA. EMMONS, n. 2 *supra*, at 250. See notes 77-92, *infra*.

On the tax aspects of legal services plans, see Hall, *Operation of Group Legal Services Plans Not Clear: Additional Guidelines Needed*, 46 J. TAX. 108 (1977); Comment, *Tax Policies in Relation to Non-Business Legal Expenses and Prepaid Legal Services: The Inequities of New Sections 120 & 501 (c) (20) of the I.R.C. and a Call for a Deduction of All Nonbusiness Legal Expenses*, 26 AM. U. L. REV. 451 (1977).

76. May 1978 JURIS DOCTOR at 10. Unions favor closed panel plans because of their earlier experience with costly and inefficient open panel medical services plans. *Id.*; BERNSTEIN & DEMENT, note 72 *supra*.

77. 29 U.S.C.A. § 1001 *et seq.* (1975).

78. *Id.* § 1003 (a).

79. *Id.* § 1002 (3).

80. *Id.* § 1002 (1).

to employee benefit plans.⁸¹ However, the supersedure provision is not to be construed as to exempt any person from compliance with state insurance laws,⁸² provided that neither an employee benefit plan nor any trust established under such a plan shall be deemed to be an insurer for the purposes of state insurance laws.⁸³ It has been noted that this "'proviso' to a 'proviso'" situation makes for ambiguity.⁸⁴

Not only is the supersedure provision unclear once it is determined that ERISA applies, but rules promulgated by the Department of Labor add further ambiguity by providing for both limited and total exemption from ERISA's provisions.⁸⁵

Small plans can be exempted from most of the reporting requirements of ERISA in several situations. The first is a welfare benefit plan that has fewer than one hundred participants during a plan year and in which benefits are paid as needed solely from the general assets of the employer or employee organization maintaining the plan. This is also true when the benefits are provided exclusively through insurance contracts or policies if the premiums are paid directly by the employer or employee organization from general assets, or partly from general assets and partly from contributions by employees or members.⁸⁶

81. *Id.* § 1144 (a).

82. *Id.* § 1144 (b) (2) (A).

83. *Id.* § 1144 (b) (2) (B).

84. Brummond, *The Legal Status of Uninsured, Noncollectively—Bargained Multiple Employer Welfare Trusts Under ERISA and State Insurance Laws*, 28 SYRACUSE L. REV. 701, 724 (1977) [hereinafter cited as BRUMMOND].

The scope of ERISA's supersedure provisions cannot be resolved in the space allocated for this comment, however, a Court of Appeals decision holding that ERISA does not preempt the application of state law to group insurance policies purchased by an employee benefit plan where the question was regulating the content of the policies and not subjecting the plan to regulation as an insurer is now pending before the United States Supreme Court. *Wadsworth v. Whaland*, 562 F. 2d 70 (1st Cir. 1977), *petition for cert. filed*, 46 U.S.L.W. 3403 (U.S. Nov. 29, 1977) (No. 77-765).

It has also been held that laws regulating services plans apart from traditional insurance regulation, as is the case with the new Virginia Act, are laws regulating insurance within the meaning of ERISA (29 U.S.C.A. § 1144 (b) (2) (A) (1975)). *Hewlett-Packard Co. v. Barnes*, 425 F. Supp. 1294, 1300 (N.D. Cal. 1977) (California Health Care Plan Act).

85. See, Bowers, *ERISA and Its Exceptions*, 27 BAYLOR L. REV. 475 (1975) [hereinafter cited as BOWERS]. For the general effect of and problems created by ERISA, see Pfenningstorf & Kimball, *Employee Legal Service Plans: Conflicts Between Federal and State Regulation*, 1976 AM. B. FOUNDATION RES. J. 787; Comment, *The Effect of ERISA on Prepaid Legal Services*, 27 BAYLOR L. REV. 566 (1975).

86. 29 C.F.R. § 2520.104-20 (1977); BOWERS, note 85 *supra*, at 476-77. This exemption is available where the benefits are provided by a combination of both the direct payment and insurance alternatives described in the text. *Id.* See cited sources for the particular provisions to which the exemption applies, for additional requirements for obtaining the exemption, and for examples.

A second limited exemption from certain reporting and disclosure requirements is available to group insurance plans of two or more unaffiliated employers having fewer than one hundred participants and which are not multi-employer plans, meaning principally plans which are not collectively bargained between one employee organization and more than one employer.⁸⁷ It is the exemption for multiple-employer benefit trusts that provided the immediate impetus to the recent Virginia Act.⁸⁸

Also exempt from the reporting and disclosure provisions of ERISA are unfunded or insured welfare plans maintained by an employer for the purpose of providing benefits for a select group of management or highly compensated employees.⁸⁹

There are also a number of complete or total exemptions from ERISA. A plan is not an employee welfare benefit plan if it is a group or group-type insurance program offered by an insurer to employees or members of an employee organization where there is little or no participation by the employer or employee organization.⁹⁰

Also, the sole proprietor of an unincorporated trade or business and his spouse, and a partner in a partnership are not considered to be employees.⁹¹

87. 29 C.F.R. § 2520.104-21 (1977); BOWERS, note 85 *supra*, at 477. For the definition of multi-employer plan, see 29 U.S.C.A. § 1002 (37) (1975).

To obtain the exemption, the plan must be fully insured through insurance contracts purchased by the employers and/or by their participating employees, have benefit payments made by the insurance company, and use a trust (or other entity such as a trade association) as the legal owner of the insurance contracts and the conduit for payment of premiums to the insurance company. 29 C.F.R. § 2520.104-21 (1977); BOWERS, note 85 *supra*, at 477-78. See cited sources for the particular provisions to which the exemption applies, for additional requirements for obtaining the exemption, and for examples.

On the current status of certain multiple-employer welfare trusts, see BRUMMOND, note 84 *supra*.

88. See remarks of W.H.C. Venable, Chairman of the Virginia State Bar Prepaid Legal Services Committee, printed in April 1978 VA. B. NEWS at 22. Mr. Venable noted that as a number of these trusts have failed nationally and that since the federal regulations do not apply, the consumer is left unprotected. *Id.* See also, BRUMMOND, note 84 *supra*.

89. 29 C.F.R. § 2520.104-24 (1977); BOWERS, note 85 *supra*, at 478-79. To qualify, benefits must be paid as needed solely from the general assets of the employer; benefits are provided exclusively through insurance contracts or policies, the premiums for which are paid directly by the employer from its general assets, issued by an insurance company or similar organization; or both. 29 C.F.R. § 2520.104-24 (c) (1977); BOWERS, note 85 *supra*, at 479.

90. 29 C.F.R. § 2510.3-1 (j) (1977); BOWERS, note 85 *supra*, at 478. No contributions can be made by an employer or an employee organization. Participation must be completely voluntary. The sole functions of the employer or employee organization must be limited to permitting the program to be publicized to employees or members, and collecting premiums and remitting them to the insurer. Finally, the employer or employee organization can receive no consideration other than compensation for administrative services.

91. 29 U.S.C.A. § 1002 (6) (1975); 29 C.F.R. § 2510.3-3 (c) (1977); BOWERS, note 85 *supra*, at 479.

Thus plans covering such persons are not employee benefit plans.⁹²

The Virginia Act covers those plans which are thus exempt from the supersedure provisions of ERISA and which are not regulated under Virginia law as insurance.⁹³

V. CONCLUSION

While prepaid legal services have received encouragement from recent decisions, statutes, and rules of court, there has been some lack of clarity as to how these new laws fit together, and more particularly, how they affect the preexisting legal framework. Perhaps the primary area of confusion has been the applicability of the antitrust laws to prepaid legal services and to the legal profession generally.⁹⁴

At the time of the Houston Amendments to the ABA Code of Professional Responsibility,⁹⁵ the Justice Department made it clear that any attempt to discriminate against closed panel plans by adoption of the amendments would be prosecuted as a combination in restraint of trade.⁹⁶ Thus the Chicago Amendments were adopted.⁹⁷ Since that time, however, the status of the organized bar as defendant in an antitrust action has been further defined by two much discussed Supreme Court decisions involving related conflicts between Canon II and the first amendment and/or the antitrust laws.

In *Goldfarb v. Virginia State Bar*,⁹⁸ the minimum fee schedule there involved was held to constitute pricefixing.⁹⁹ Any "learned professions" exemption was substantially modified if not totally discarded.¹⁰⁰ Even though the Virginia State Bar was acting as an administrative agency of the Virginia Supreme Court, its issuing of advisory opinions holding that fee schedules were enforceable was found not to fit within the state action exemption of *Parker v. Brown*.¹⁰¹ The Court, however, noted that the Virginia Supreme Court had neither endorsed nor adopted the opinions.¹⁰²

92. 29 U.S.C.A. § 1002 (1) & (3) (1975); BOWERS, note 85 *supra*, at 479.

93. See notes 2 & 3, *supra*.

94. See generally, Meeks, *Antitrust Aspects of Prepaid Legal Services Plans*, 1976 AM. B. FOUNDATION RES. J. 855; Note, *The Organized Bar and Prepaid Legal Services—An Antitrust Analysis*, 1975 WASH. U. L. Q. 1011; SYRACUSE NOTE, note 60 *supra*.

95. See notes 59-65 *supra*, and accompanying text.

96. EMMONS, note 27 *supra* at 250; BERNSTEIN & DEMENT, note 72 *supra*, at 74; ANTITRUST PROBLEMS, note 62 *supra*; TUNNEY SUBCOMMITTEE, note 64 *supra*.

97. See notes 66-71 *supra*, and accompanying text.

98. 421 U.S. 773 (1975).

99. *Id.* at 782-83, 785.

100. *Id.* at 787-88.

101. 317 U.S. 341 (1943).

102. *Goldfarb v. Virginia State Bar*, 421 U.S. 773, 790-91 (1975). On the current status of

In *Bates v. Arizona State Bar*,¹⁰³ the Court unanimously held that the Arizona Supreme Court's adoption of disciplinary rules prohibiting lawyers from advertising was state action exempted from coverage of the anti-trust laws.¹⁰⁴ Thus, proscriptions imposed on legal services plans by the Code of Professional Responsibility and state statutes are apparently not governed by the antitrust laws and are therefore to be limited by federal law statutorily preempting state regulation¹⁰⁵ and constitutionally protecting certain activities.¹⁰⁶ This does not, however, mean that legal services plans or other activity by the organized bar is protected from antitrust laws.¹⁰⁷

One way the organized bar may come under Justice Department scrutiny could be if it sponsored an open panel plan which adopted a schedule of maximum fees to be paid for the services offered by the plan. Such an arrangement could be viewed as price fixing if prices in the particular market were found to be affected.¹⁰⁸ This concern would be heightened if the schedule were based on actuarial data gathered in an area, such as Virginia, where bar association minimum fee schedules have been in effect.¹⁰⁹

A non-bar sponsored plan might also be guilty of price fixing if it is operated by a group of attorneys otherwise in competition with one another that adopts a maximum fee schedule which affects prices in the market. For example, in *Blue Cross v. Commonwealth*,¹¹⁰ a group of hospitals operated a prepaid drug plan through their agent, Blue Cross of Virginia. The

the advisory opinion process, see *Surety Title Insurance Agency, Inc. v. Virginia State Bar*, 431 F. Supp. 298 (E.D. Va. 1977) (Merhige, J.) (enjoining the defendant from issuing any further opinions defining the practice of law in this case on the ground that such a practice constituted a group boycott), *vacated*, 571 F. 2d 205 (4th Cir. 1978) (remanding the case with orders to stay proceedings pending appellate review of a Norfolk Circuit Court unauthorized practice action by the Commonwealth against the plaintiff in the federal case on the ground that the State case would clarify the roles of the Virginia State Bar and the Virginia Supreme Court in the disciplinary procedures).

On the impact of the Goldfarb case on the state action exemption, see Shenefield & Hartwell, *Annual Survey of Antitrust Developments 1975-1976*, 34 WASH. & LEE L. REV. 7, 21 (1977); Shenefield, *Annual Survey of Antitrust Developments 1974-1975*, 33 WASH. & LEE L. REV. 259, 289 (1976).

103. 97 S. Ct. 2691 (1977).

104. *Id.* at 2696-98. On the impact of this case on the state action exemption, see Carstensen, *Annual Survey of Antitrust Developments 1976-1977*, 35 WASH. & LEE L. REV. 1, 57 (1978).

105. See notes 77-93 *supra*.

106. See notes 26-34 & 39-49 *supra*.

107. See sources cited in note 94 *supra*.

108. SYRACUSE NOTE, note 60 *supra*, at 764-66.

109. *Id.* at 767.

110. 211 Va. 180, 176 S.E. 2d 439 (1970), commented on in 12 WM. & MARY L. REV. 676 (1971).

plan adopted a repayment schedule whereby pharmacists selling prescriptions to subscribers of the plan were reimbursed at cost plus a fixed amount. The Virginia Supreme Court held that such a large supplier of services as this group of hospitals could not fix the prices charged by participating pharmacists.¹¹¹ It has been suggested that the way to avoid this sort of problem is to eliminate provider control of pricing decisions.¹¹² However, this will be somewhat difficult for a group of attorneys operating a plan in corporate form because of the requirement that the majority of the board of directors of such a corporation be providers of legal services.¹¹³ While the foregoing discussion has been limited to price fixing, there are other possible antitrust violations such as monopoly, boycott, and unfair competition.¹¹⁴

While some uncertainty still surrounds the operation of legal services plans, there are a good number of plans doing business. The Virginia State Bar has been actively involved in this field since 1976 when the Foundation for Prepaid Legal Services of Virginia was created.¹¹⁵ The Foundation has a program, administered and underwritten by the Midwest Mutual Insurance Company, which offers both open and closed panel plans.¹¹⁶

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111. SYRACUSE NOTE, note 60 *supra*, at 766-67; 12 WM. & MARY L. REV. 676 (1971).

112. SYRACUSE NOTE, note 60 *supra*, at 767.

113. VA. CODE ANN. § 38.1-797 (Cum. Supp. 1978).

114. See sources cited in note 94 *supra*.

115. Report of the Committee on Prepaid Legal Services, printed in Sept. 1976 VA. B. NEWS at 6.

116. Report of the Committee on Prepaid Legal Services, printed in May-June 1976 VA. B. NEWS at 40. For further details see, March-April 1976 VA. B. NEWS at 52.

In addition to marketing the program to unions, employers, and other organizations, the Foundation and Midwest Mutual have recently received a grant from the National Legal Services Corporation under which both open and closed panel services and indemnity plans are being operated and studied as an alternative method of providing legal services to the poor. March 1978 VA. B. NEWS at 2.