Key Issues in Professional Liability Insurance Coverage

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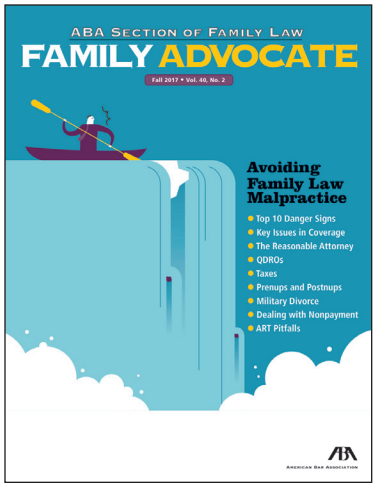

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Lawyers in every area of the law should carry professional liability (PL) insurance to protect their assets and livelihoods in the event of a malpractice claim. But the risk of a claim can be especially acute in family law, where the litigants have very personal stakes in an action and where emotions run high. Without coverage, defending even a meritless claim can quickly consume a lawyer's time, money, and energy. Ensuring that you procure and maintain the coverage you need is an ongoing concern, from the insurance application process through the resolution of a claim. This article will discuss some of the key elements of typical PL policy coverage and important compliance requirements.

Limits, Deductibles, and Premiums

Attorneys applying for insurance should carefully choose their coverage in light of the matters they handle. As the value of a dispute increases, so do the potential financial consequences of an attorney's error and the potential insurance exposure. Insured attorneys can save on premiums by getting policies with lower limits, but they should be careful not to let these up-front savings translate into large uninsured liabilities that put their personal assets and the assets of their firms at risk. If you take on a case that is unusually large compared to your usual book of business, you may want to contact your insurer or broker to discuss increasing the limits of the policy already in effect, rather than waiting until the renewal date to get more coverage. Another option is to purchase an excess liability policy that applies only after a primary policy has been exhausted. In proportion to the amount of coverage provided, premiums on excess policies are generally lower because most claims are resolved within the primary layer of coverage and because the primary insurer bears the cost of defending claims.

Besides the policy limits, several other terms in the policy may affect both the premiums and the amount of coverage that is ultimately available. A large deductible or self-insured retention may make the policy more affordable, but it can also make any claims more expensive for the attorney. The insurer may offer the option of an indemnity-only deductible, meaning that the attorney does not have to pay any of the defense costs but will pay part of any judgment or settlement that may be entered.

Another potential premium-saving option is for defense costs to come out of the policy limit and erode the amount left for indemnity. Unfortunately, this means that the longer a malpractice suit remains pending, the less coverage the attorney has left to pay a judgment or settlement. The attorney may therefore ultimately have the least coverage for the most contentious cases.

Some policies have separate sublimits for specific risks such as disciplinary proceedings, which usually have a single limit that includes both defense costs and indemnity. Lawyers should know which limits will apply at the outset of the insurer's defense of a claim or disciplinary proceeding and whether defense costs are included within the limits.

Claims-Made Coverage and Reporting Requirements

One of the most familiar types of insurance is a commercial general liability (CGL) policy that provides occurrence-based coverage applying to bodily injury or property damage that occurs within the policy period, even if no suit is filed until years later. Most PL policies, in contrast, are written on a claims-made basis and cover claims first made against the insured lawyer within the policy period. Such policies may take the form of claims-made-and-reported coverage, requiring that the claim be both made against the lawyer and reported to the carrier within the policy period.

Insurers providing claims-made or claims-made-and-reported coverage are insuring against the risk that a claim will be made, rather than the risk that events giving rise to a claim will occur. Under such policies, the acts giving rise to the claim can occur before the beginning of the policy period so long as they occur after the retroactive date specified in the policy. However, insurance policies are designed to protect against the *risk* of liability, and not against known liabilities. An insurer will therefore generally not cover a claim if, at the time the attorney is applying for coverage, the attorney could have foreseen the claim or reasonably could have believed the underlying act or omission was a breach of a professional duty.

The Key Question

The key question in this regard is when a lawyer can foresee a claim or reasonably believe an act constituted a breach of a professional duty. Questions of foreseeability and reasonable belief are likely to be fact-dependent, and, unfortunately, it is therefore difficult to prescribe a bright-line rule for when an attorney should report a potential claim. But foreseeability will usually be determined by an objective standard, rather than by what attorneys claim they subjectively expected. This means an insurer may not owe coverage for a claim that the lawyer should have been able to foresee based on *any* facts or circumstances at the time of applying for coverage, regardless of whether the potential claimant has made a direct threat or has even been made aware of an arguable breach at that time. If a client threatens to file suit or tells an attorney to put his or her carrier on notice, such threats certainly make it foreseeable that a claim may be brought. An attorney should always err on the side of reporting and let the insurer decide whether to accept or reject such notice.

If an attorney can foresee a potential claim, the safest thing for the attorney to do is to disclose that potential claim immediately to his or her current carrier, rather than waiting and reporting the claim when and if it is actually brought. If the attorney reports a potential claim to the current carrier, the policy will generally treat the eventual claim as having been made when the potential for that claim was reported, even if no claim is actually made until a subsequent policy period. The attorney should therefore report the claim to the same insurer already notified.

Don't "Wait and See"

Lawyers are understandably reluctant to disclose potential claims because they often believe that they did nothing wrong and that nothing will come of a threat or a dispute. However, there are several reasons that attorneys should not take a wait-and-see approach and put off reporting potential claims.

If a lawyer does not report a potential claim under an existing policy but only discloses it in the application for a new policy, the new insurer might either draft an endorsement specifically excluding the claim from coverage or else raise the premiums to provide coverage for it. If the lawyer *fails* to disclose a foreseeable claim in the application, that failure may be considered a material misrepresentation, which could have the effect of not merely precluding coverage for that claim but

even prompting the insurer to seek to rescind the entire policy. Rescission is based on the premise that there was no meeting of the minds, and it seeks to put the parties in the same position they would have been in had the policy never existed. The failure to disclose *one* foreseeable claim could therefore deprive a lawyer of coverage for *all* claims brought under the policy. Moreover, the attorney might have to bear the cost of not only defending the underlying case but also litigating a coverage dispute with the carrier.

Be Candid

If an attorney switches carriers without having disclosed a potential claim, he or she could get stuck in a situation where the first carrier disclaims coverage because the potential claim was not disclosed within its policy period and the second carrier disclaims coverage because the lawyer could have foreseen the claim when applying for the second policy. The best practice is therefore for an attorney to report potential claims to the current insurer as soon as he or she becomes aware of them and to be candid in any applications for new policies with respect to questions about claims and potential claims reported to prior insurers.

Defense and Indemnity

As a general rule, an insurer has separate duties to defend and indemnify an insured lawyer. The duty to defend is much broader and is triggered if a claim even potentially comes within the scope of the policy, while the duty to indemnify (i.e., to pay a judgment or settlement) arises only if there is actually coverage for a claim. The insurer might therefore offer a defense under a reservation of rights, identifying the specific policy defenses that may apply and protecting the insurer's ability to disclaim coverage if litigation reveals facts showing that a claim is not covered.

The insurer will often assign defense counsel, but if the insurer's reservation of rights gives rise to a conflict of interest between the insurer and the attorney, the attorney may have a right to select counsel of his or her choice at the insurer's expense. A conflict may arise if the claimant alleges both covered and uncovered causes of action against the lawyer, such as when one count alleges negligence and another alleges intentional and malicious conduct. A conflict may also arise if the facts developed by defense counsel have the potential to take the suit outside the scope of coverage, or possibly if the attorney's potential exposure exceeds the limits of the policy.

Typical Exclusions

A claim could come within the insuring agreement but still represent a risk that the insurance policy is not intended to cover, so the next question is whether any exclusions apply. While the exact terms will vary from policy to policy, a few typical exclusions follow.

Some exclusions illustrate the "dovetail theory" of coverage, which presumes that two policies such as a CGL policy and a PL policy are intended to protect an insured without any gaps or overlaps. A PL policy will therefore exclude risks that a CGL policy would ordinarily cover, such as claims alleging bodily injury or property damage. A CGL policy will also usually cover offenses that come within the defined term "personal injury," such as false arrest, false imprisonment, invasion of privacy, malicious prosecution, abuse of process, or defamation. But if such offenses arise from the rendering of professional services, they may be excluded from the CGL policy and covered under the PL policy instead. In other cases, such as auto claims, both the CGL policy and the PL policy may exclude a risk, and insureds wanting coverage for such

The Insuring Agreement

A typical insuring agreement may say that the policy covers sums an *insured* must pay as *damages* because of a *claim* resulting from an act or omission in the performance of *professional services* or a failure to perform them. Each of these defined terms deserves a closer look.

Insured

This term is straightforward when a claimant sues the firm listed in the policy declarations or one of its member attorneys, but plenty of issues can arise that will make the precise definition important.

A firm may have potential liabilities regarding attorneys who share space with it, who cover court appearances in an emergency, or who are performing temporary work as contract attorneys, not to mention paralegals and other nonattorney staff. When a firm hires a new attorney, it should make sure to provide whatever notice the insurer requires, which is likely to include potential claims from that attorney's work with a prior employer.

Damages

This term is usually limited to requests for monetary relief, and the policy will likely not cover a suit that solely seeks an injunction directing the insured attorney to perform a task. Moreover, not all monetary relief necessarily qualifies as damages, and the policy may limit the scope of coverage either in the definition of "damages" or in the policy's exclusions. The definition may exclude sums such as punitive damages, fines, or penalties, and regardless of the policy terms, punitive damages are uninsurable in some states as a matter of law and public policy. The policy may also exclude disputes over the return or alteration of legal fees paid to the attorney. If an attorney demands payment from the client and the client then files a suit (or a counterclaim) that solely seeks to dispute the amount of fees to which the attorney is entitled, there may not be coverage for the client's claims. However, if the client also seeks money damages based on allegations that the attorney's negligence cost the client some meritorious claim or defense, such claims may trigger the insurer's duties.

Claim

The term "claim" is usually defined broadly enough to encompass far more than the actual filing of a suit or a disciplinary complaint against an attorney. Any oral or written demand for money or services may constitute a "claim" under the policy, but again, a demand for services alone might not trigger the insurer's duties if the claimant does not seek "damages."

Professional Services

This term is crucial for distinguishing whether a claim comes within a PL policy or other insurance such as a CGL policy. Most covered claims will relate to services performed as an attorney representing or advising a client, but this definition may also cover the attorney in roles such as arbitrator, mediator, bankruptcy trustee, or speaker or author on a legal topic. Coverage for roles such as administrator, executor, receiver, or guardian may be limited to services in those roles that an attorney would typically perform. Some "clerical" errors will not be covered because they do not involve the use of any specialized knowledge or skill but are simply cases of faulty recordkeeping; however, something like a failure to file suit on time may arise out of "professional services" because it still requires the attorney's judgment as to the applicable statute of limitations.

—R.J.V.

claims will have to procure a separate specialized policy.

Other common exclusions that illustrate the "dovetail theory" exclude liabilities arising out of an attorney's role as an officer, director, or owner of a business enterprise, or as a public official or a government employee. A business may have coverage under a directors' and officers' liability (D&O) policy for claims arising from the exercise of an officer's business judgment, and a governmental body may have a public entity liability policy or a pool of self-insurance for claims arising from a public official's discretionary acts. The rationale for these exclusions in the PL policy, as well as for exclusions for claims arising out of matters such as investment advice or securities work, is that such services do not represent the same types of risks occurring in an attorney's traditional practice of providing a client with legal analysis, advice, and representation.

The attorney should review the terms of all available policies to ensure that claims are reported to the correct insurer. The broker who procured the policies may be able to help with this determination. If there is any doubt over which policy will apply, it would be prudent for an attorney to report the claim to both carriers, which then will analyze coverage for the claim and will advise the attorney of their conclusions. If a single claim *potentially* comes within the coverage of more than one policy and therefore within the scope of each insurer's duty to defend, the policies' "other insurance" clauses may determine whether one policy's coverage is primary and the other is excess or whether the insurers must share the cost of defending the claim.

Other exclusions relate to risks that no policy is likely to cover. For instance, many PL policies contain an "insured versus insured" exclusion precluding coverage for disputes between different members of a firm unless one lawyer is in an attorney-client relationship with the other. No insurer wants to bear the costs of personal and rancorous disputes over compensation or over the allocation of assets, clients, or cases when a firm dissolves or divides.

Some exclusions relate to claims of intentional conduct such as discrimination, conspiracy, or fraud. Just as with punitive damages, public policy sometimes prevents insureds from insuring themselves against the consequences of such wrongful acts. These exclusions may provide that the insurer will still defend an insured attorney until a court has determined that the attorney engaged in illegal, dishonest, fraudulent, or criminal conduct. This limitation relates to the general rule that an insurer has a duty to defend the insured against groundless, false, or fraudulent claims. But if an attorney is convicted of illegal or criminal conduct, there is no longer any doubt that the exclusion applies. Depending on state law and policy terms, the insurer may be able to withdraw immediately from the defense and even to demand that the lawyer reimburse it for defense costs that the insurer incurred before determining that the claim was not covered.

Conditions

An insurer's duties to defend and indemnify an insured attorney are also contingent on satisfaction of the policy's conditions, which impose a number of duties on the attorney in addition to the reporting requirements discussed above.

Policies require insured lawyers to cooperate with the insurer, and this obligation continues throughout the pendency of the claim. The lawyers must provide any information that the insurer or defense counsel needs to investigate or defend against the claim by providing documents, giving written statements, or appearing for an examination by the insurer's representative. The lawyers must also appear for any events where their attendance is required, such as their depositions, trial, or arbitration. If attorneys voluntarily make any payments or assume any obligations without the insurer's consent, they do so at their own expense and risk.

Most policies have a "consent to settle" clause requiring the attorney's permission before the insurer settles a claim. However, the catch is that if an attorney refuses to consent to a settlement that the insurer recommends, that refusal may relieve the insurer of any further duty to defend and may limit the insurer's obligations to the amount of the proposed settlement. As a result, although lawyers are often averse to settling claims that they believe are without merit, they are forced to yield to the insurer's business determination of what constitutes a fair and reasonable settlement.

Either in the conditions or in the definition of "insured," policies often have a "separation of insureds" or "severability of interests" clause. Such provisions state that an insurer has separate duties to each insured attorney and will analyze coverage for each attorney as if he or she were the only insured. If several attorneys are sued

and only one of them could have foreseen that the claim would be brought but failed to disclose it, the insurer might disclaim coverage for that attorney but defend the others. Courts sometimes discuss this result in terms of the "innocent insured" doctrine that allows an insured who is innocent of wrongdoing to recover under the policy despite the wrongdoing of other insureds.

Conclusion

Professional liability insurance is always a valuable tool for protecting an attorney against claims, but it becomes even more valuable if an insured attorney knows precisely what the terms of the policy cover and how to preserve that coverage. Attorneys should also remember that skilled professionals are available to help them. These professionals include brokers who regularly procure such policies and know what options are available and coverage attorneys familiar with the law concerning the interpretation and enforcement of insurance policies in the event of a dispute. **FA**

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