LEGAL MALPRACTICE INSURANCE

BY MARCUS R. CUSICK, CIC

There are many names for lawyers' professional liability insurance: "Legal Malpractice Insurance," "E&O (Errors & Omissions) Insurance" and "Professional Responsibility Insurance." This article will attempt to summarize the key aspects to be considered by attorneys when evaluating coverage offers. A specialized broker will be able to answer more specific questions and provide resources for a thorough (if boring) study.

Attorneys generally understand their coverage and the reasons for buying it. The state of Nevada does not require that attorneys be covered but, in response to public requests, the State Bar of Nevada does attempt to let potential clients know which lawyers have malpractice coverage, via its website.

Claims-Made Policy Form, Retroactive Date and Tail

An attorney's coverage is nearly always on a claims-made policy form that protects professionals from claims arising from services provided after the policy's retroactive date, and reported while the current policy is in force. Your retroactive date usually reflects the first date of uninterrupted coverage. As long as the coverage is continuously renewed, claims may be reported to the current carrier for errors or omissions dating back to the retroactive date. This differs from occurrence policy forms used in standard casualty insurance that protect against claims occurring while the policy is in force, regardless of when the claim is reported.

Thus, if a firm's coverage ends due to firm dissolution, acquisition, non-payment or the firm's inability to secure coverage dating back to the retroactive

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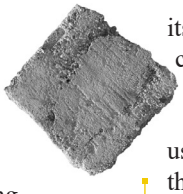
date, the policy provides an optional tail. Often referred to as an "extended reporting period," The tail allows the reporting of claims, after the policy has ended, for errors or omissions that took place while the policy was still in force, dating back to the retroactive date. The policy or quote will list the term of each tail option along with its attendant cost: usually a multiple of the annual premium. For example, it may offer a tail of one year to report claims for 100 percent of the annual premium, two years for 200 percent or three years for 300 percent. Some carriers offer unlimited tail periods.

It is also worth noting that some policy forms provide a free tail at retirement if the policyholder's coverage has been with the same carrier for a minimum number of years.

Pricing



Premiums for this coverage are based on a typical formula, applied by each carrier in its own way. Most build their formula using these factors: number of attorneys, coverage enhancements, retroactive dates, limits, deductibles, practice areas, recent claims, geography and other considerations. Generally, rates have increased slightly during each of the past few years. This is more pronounced in counties where litigation and claims are more frequent or expensive.

The Application

Most insurers still request an annual paper application. The application can be obtained from a specialized agent and will normally allow the agent to seek premium and coverage indications from multiple insurance companies. Independent agents represent dozens of carriers, though they often don't represent the few direct writers operating in the state. Direct writers have employees that act as company representatives. Thus, they are limited to offering coverage from only one insurer.

The most important question on the firm's application asks, "is the firm or its attorneys aware of any unreported claims or potential pending claims?" The firm's attorneys should be surveyed at the time the application is completed, using the exact language that appears on the application, and then again just prior to binding. This survey is critical when it comes to preventing uncovered claims, especially prior to switching carriers.

Areas of Practice

The practice areas of intellectual property, securities, class action and personal injury are historically more risky than many others. Real estate practice has experienced a sharp increase in claims since the turmoil within the real estate market beginning in 2008.

Limits and Deductibles

When comparing insurance proposals, a buyer's attention is quickly focused on the premium; then, often they navigate toward the limits and deductible. The limits are listed as "per claim" and "aggregate." Take note of whether or not the limits will be eroded/reduced by claims defense costs. This is typical and is referred to as "defense inside" or "defense costs within the limit." Some carriers offer "defense outside," though often it requires an additional premium.

Deductibles feature a few variations as well. Typically a deductible is per claim: a deductible for each and every claim during a policy year. Some carriers offer an aggregate deductible for an additional premium, meaning there is only one deductible for the policy year, regardless of how many claims are incurred. One final variant is a first-dollar defense: an enhancement to the deductible under which the carrier defends the claim without charging a deductible, unless a settlement or judgment is entered. This is an increasingly rare option and often requires and additional premium.

What is a Claim?

Lawyers must report more than simply claims. The notice provision of a policy requires that lawyers disclose

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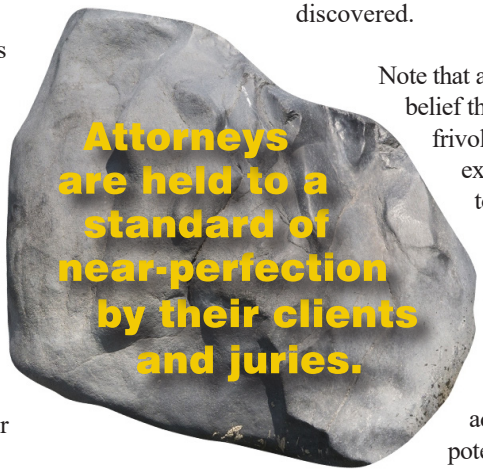
to the malpractice carrier not only existing claims, but also potential claims. A potential claim is often any fact or circumstance of which the lawyer is aware, which may give rise to a claim. Each year, the application will require that lawyers report any potential claims.

While not specifically defined, the following are often cited as circumstances indicating potential claims:

- Client demands you waive or refund their fees;
- Written request to toll or waive a statute relating to a potential civil or administrative proceeding;
- Client alleges malpractice or threatens, verbally or in writing, to sue;
- Client requests his or her file;
- Client initiates a bar complaint — remember that many policies provide deductible-free defense and loss of earning coverage for response to bar complaints;
- Client reports a firm to the fee dispute panel of the bar; and
- If an attorney is considering explaining an error or omission to the client or state bar, there is likely a duty to report it to the carrier as well.



Legal malpractice insurance carriers often provide confidential hotlines for free consultation regarding potential claims. The American Bar Association also has a potential claims hotline for its members. We suggest contacting the carrier or a hotline if you are faced with anything that may give rise to a claim.

Failure to Report Claims

A lawyer's failure to immediately report potential claims could result in a loss of coverage. Entering into settlement talks or defending a claim without reporting that claim allows the carrier to deny coverage later.

Coverage can be lost in at least two ways:

1. Failure to disclose a potential claim on an application gives the insurer the right to rescind the policy entirely if the misrepresentation is material. The policy is void and the premium refunded, leaving no coverage for any insured.
2. Most claims-made policies do not cover any act, error or omission that an insured could reasonably have foreseen at the time the policy was purchased. A report to the carrier should have been made when the potential claim was discovered.

Note that an insured's belief that a claim is frivolous is not an excuse for failing to give notice; the insurer has a duty to defend even frivolous claims and prefers to know in advance about all potential claims.

Lawyers should take their own advice and seek counsel. Carriers are ready, willing and able to assist with claim mitigation efforts and client disclosure. Often the carrier will provide ethics and malpractice experts to assist in reporting ethical matters and disclosing issues to clients in a way that preserves any defenses to a potential claim.

Consent to Settle and Non-renewal

Under the claims-made policy form, it is very important to report claims and potential claims as soon as possible. The timely reporting of claims is a duty of the insured. Most policies require a firm's consent to settle, but the policy will dictate that, if the firm chooses to continue its defense beyond a potential settlement, it may be liable for all, or some of, the costs. This is referred to as a "hammer clause." These clauses become interesting when a defense attorney asks for blanket consent to settle. The hammer clause will only pose a risk to the insured if they reject a specific settlement offer. Thus, the insured may opt to continue defense until a specific settlement is offered with no risk under this clause. There is much variation in consent to settle clauses, so consult your policy for reference.

Firms experiencing serious claims may face non-renewal and be forced to seek coverage at higher premiums with lower limits and, possibly, no prior acts coverage. If this occurs, the firm must consider purchasing a tail while simultaneously procuring coverage going forward: a very expensive proposition indeed.

Disciplinary

Most attorneys are not aware that their malpractice policy might provide for defense and response to disciplinary matters, including covering a firm's loss of earnings. This benefit is not usually subject to the deductible and carries a smaller sub-limit, typically on the order of $25,000.

Attorneys are held to a standard of near-perfection by their clients and juries. Thus, they should always work toward improved risk management. A knowledgeable broker can offer the resources necessary to audit a firm's practices and make recommendations for improvement. If a firm wants to pay a lower premium and have more coverage options, it should improve its application and effectively communicate to the underwriters the reasons the firm is a good, better or improving risk. The best firms show their underwriters documented efforts to prevent claims. NL

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