

AFFINITY ADVANTAGE

LAWYERS' PROFESSIONAL LIABILITY

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MALPRACTICE INSURANCE FOR THE LAW FIRM PROFESSIONAL

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Why do insurance companies ask the questions they do? What is “underwriting”? And what does it have to do with paying my claim? I am a good lawyer, so why are my malpractice insurance premiums so high? This article attempts to answer some of these questions and to help you better understand your professional liability insurance needs as a solo or small firm practitioner.

The first question must be, why do I need professional liability insurance? My answer to that is simple- mistakes happen, and the financial burden to defend one's actions can be devastating. And it is not necessary that you make a “mistake”, it is only necessary that your client perceives that a mistake was made or that their expectation of a result was unmet.

The American Bar Association started collecting law firm claims data in 1988. A review of that data would show that anywhere between 4 and 6 percent of lawyers has a claim in any given year. Most never have a claim. Sixty five percent of all claims come from firms with between 1 and 5 lawyers. While approximately half of those claims did not lead to a loss payment, there were defense costs. Out of the 30,000 claims reviewed in the last American Bar Association study, a small but significant minority paid expenses in excess of \$50,000.

In many regions the lawyer has several outlets from which to purchase professional liability coverage, all of us marketing ourselves. You choose from whom you buy. So let's talk a few necessary concepts.

What is “Claims Made”

“Claims made” is the only available type of policy for lawyers professional. It is unlike



your automobile or homeowner's policy. In these policies, the accident happens, and three or four years later (statutes of limitations aside), you are sued. The policy in force at the time of the accident is the policy that responds to the claim. These are called “occurrence” policies because the occurrence triggers the loss defense. These occurrence forms have generally not been available for lawyers since the late 1980s.

Claims Made is a policy that is triggered by when the claim is made against the law firm. In its purest form, it means that the policy in force when the claim is actually made against you is the policy that will defend (assuming there is coverage), regardless of when the “accident” or incident occurred. It is a mechanism for underwriters to use current pricing structures to more adequately pay for the claims that are presented. But few “pure” policies are sold.

Some key terms:

- **RETROACTIVE DATE** or **PRIOR ACTS DATE**. This is the date when coverage starts. Any claim against the policy must **BOTH** occur and be made after this date.

- **Most policies are CLAIMS MADE AND REPORTED**, which means not only that the claim must be made in the policy year, but also reported in the same policy year. A circumstance that becomes known must be reported in that policy year, or the lawyer runs the risk of a declination in the future.

- **NOTICE**. The notice provisions of the policy generally require the insured to report a claim as soon as practical. Prompt reporting protects your rights to coverage in the future.

- **APPLICATION**. The application generally becomes part of the policy and statements therein are relied upon by the insurance company. Some companies treat the statements made in the application as warranties made by the applicant firm. Most treat them as representations. Misstatements or false statements can lead to the rescission of the policy.

- **EXTENDED REPORTING PERIOD**. There are legitimate circumstances under which a claims made policy must end. These could include the death of the lawyer, the dissolution of the firm, the non-renewal of coverage and subsequent inability for the firm to purchase prior acts coverage. Most

claims made policies contain a provision that for a sum of money, the policy can extend the period of time (into the future) during which a claimant can make a claim against the policy. For an additional premium, a firm can purchase a block of time equal to one, two, three years or up to an unlimited period. This “tail” period would apply to claims that are brought against the firm or attorney at a future date, but where the act was committed while the policy was in force. The “Tail” does not apply to new errors committed after the original policy was cancelled or not otherwise renewed. It is important to note that most companies extend the last policy period and whatever limits are left in that policy. If there have been claims, then the limit is decreased by that amount.

What is a claim?

A claim is a demand for money or a demand for a refund, free work or something similar. A circumstance is an act or situation that could give rise to a claim, such as an expression of dissatisfaction with the work done, or a fact pattern where a claim is possible. Let me give you an example.

An estate planning attorney is assisting the spouse of a nursing home patient (the actual client) in an application for Medicaid. He advises that the spouse contact one of a list of financial advisors to annuitize excess assets to comply with Medicaid assistance guidelines by keeping those assets below a regulated limit. The spouse engages her own advisor, who annuitizes close to the limit. The application was denied as the total assets had grown in value and were then above the set limit. The firm has since appealed on the basis that there is no regulation that assets be kept below that limit after the application is made, but no decision has been made. The spouse has expressed frustration and unhappiness and has pointed the finger of blame, but no demand for damages. Is this a circumstance?

The review of the fact pattern is important because if the circumstance goes unreported and later develops into a claim, the insurance company’s discovery process may reveal the prior knowledge of the insured, leading it to either deny coverage or offer defense with a reservation of their right to decline at a future date. It is often better to report the potential claim, than to run the risk of denial.

What effect does a claim have on underwriting?

Every insurance company has an established procedure about claims and pricing. These schemes almost always involve the use of a “surcharge” that is applied to the base premium. However, the following should be noted:

- The use of the surcharge is usually determined by the size of the claim, often as a function of the deductible (for example, a claim is not subject to a surcharge unless the paid or reserved value exceeds twice the deductible).
- That surcharge usually applies in a declining percentage for a period of up to 5 years. That percentage varies with the company, but could be as high as 50%.

Frequency and severity of claims are also key issues. Underwriters are usually far more concerned with a frequency of smaller claims than the one large loss. That’s not to say that a company’s reaction to a large loss can’t be punitive (such as non-renewal). A series of small claims is often indicative of some activity that is endemic within the firm, inadequate supervision for example. A large loss is most often not indicative of a firm’s risk management procedures. A single large loss is just that- a large loss.

What Limit of Liability should I buy?

There is no clear path to choosing the limit of liability for a law firm. Often the decision is driven by cost, sometimes by client demand. Here are some guidelines:

- Consider the monetary value of the matters handled by your firm. Consider the potential economic damage to your firm if a claim arose from your biggest case. Many lawyers rely on this worst case scenario approach. Others use a factor of 2X or 3X.
- Determine whether your practice concentrates in areas of law that have higher frequency of claims. Loss experience studies identify plaintiff personal injury and real estate matters (especially in New England) as having the highest frequency. Lower frequency areas (but still high) include business transactions, family law, collection/bankruptcy, workers compensation and estate planning.

- Take into account the personal assets of the attorneys in the firm.

- Consider the number of attorneys in the firm.

- Evaluate the known risk factors:

- o Do you have an active risk management program?

- o Are you confident in your docket, work control, conflicts check, filing, and mail handling procedures?

- o Do you have a good reputation?

- o Do you provide training for all new attorneys and staff?

- The need for higher limits may remain after the nature of services rendered changes. Does a statute of limitations apply to your work? Is it short or long? When does it trip?

- Keep in mind that the costs of defense are most often included within the limit of liability. Defense costs vary with the complexity of the case and are always paid before any indemnity. Will there be enough left?

- Understand what “Claims Made” means. It generally means that the limit of liability in force at the time the claim is made against you is the one that will defend the case. Exposure to claims GROWS over time as more and more matters were handled. Therefore the limit of liability chosen 10 years ago may not be adequate today.

- Similarly, the value of money erodes year to year, if for no other reason than simply due to inflation. \$100,000 does not buy as much today as it did 5 years ago.

Law firms, both large and small, have unique risk management and exposure issues. Certainly one insurance product does not fit all of those needs.

For more information go to:

www.usiaffinity.com/LPL

¹This article is based on a talk given by Jack Kukowski at the BBA on September 21, 2007 on insurance issues affecting solos and small firm lawyers. Mr. Kukowski is Regional Sales Executive for USI Affinity in Boston. He can be reached at 800.747.1018 or jkukowski@usiaffinity.com.