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## Malpractice

# Timing Is Everything in Law Firms' Claims for Liability Insurance Coverage

By J. LOGAN MURPHY

**A**ttorneys—in their various roles as defense attorneys, coverage counsel or even insureds—must be more sensitive to timing issues that arise in professional liability coverage questions.

This was the takeaway from a session on issues impacting coverage determinations, which took place during the Spring 2015 National Legal Malpractice Conference, held April 8-10 in Washington, D.C., and sponsored primarily by the ABA Standing Committee on Lawyers' Professional Liability.

A mixed panel of defense counsel, coverage counsel, underwriters and in-house claims managers fleshed out this sentiment with thoroughness and precision. The session was general enough to touch on many of the prickly timing issues affecting professional liability policies, yet specific enough to invoke several hypotheticals and scenarios, ranging from easy to debatable.

Moderator Kim Ashmore, a partner with Wiley Rein LLP in Washington, D.C., divided the session into three main topics: (1) policy language in claims made and reported policies; (2) the effect of prior knowledge on coverage; and (3) retroactivity and prior acts issues.

## The Language of Coverage

The first topic was handled by David Grossbaum. A partner in Hinshaw & Culbertson LLP's Boston office, Grossbaum relied on significant experience as both defense counsel and coverage counsel in analyzing common insuring language and relevant exclusions addressing the timing of claims and notice.

In any coverage question, Grossbaum said, the inquiry begins with the insuring language. In claims-made-and-reported policies, the insuring language usu-

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ally covers all sums “the Insured shall become obligated to pay as Damages for Claims first made against the Insured and reported to the Company during the Policy Period,” or other language of similar effect.

The discussion that followed focused on what constitutes a “Claim,” when the “Claim” is made, and when the “Claim” must be reported.

## What Is a ‘Claim’?

With regard to the definition of a “Claim,” Grossbaum recommended that attorneys look first to any definitions of the term in the policy itself. Some policies require that a “Claim” be made in writing, while others require only some “demand” for money or services.

The most common “Claims” are a lawsuit filed against the attorney or law firm seeking money damages and a letter to the insured demanding compensation. But there are many more variations on this theme, some of which Grossbaum explored through hypotheticals posed to the group gathered for the session. For example, if a client sends a letter to the attorney expressing dissatisfaction with services and demanding the return of the client's file, is that a “Claim” under the standard definition?

The panel agreed the answer is “probably not,” but it depends on how the relevant jurisdiction defines a “professional service.”

What about a disciplinary complaint filed against the attorney? Again, “probably not,” although some policies today define “Claim” to include disciplinary complaints.

And if the client sends a letter directly to the insurance carrier, this is almost certainly not a claim, unless it's sent in New York, where recent legislation mandates the letter be treated as one.

## Timing a Claim

Because the session focused on timing issues, the definition of a “Claim” was a necessary precursor to the evaluation of common scenarios involving attorneys' procurement of insurance at a time in close proximity with a claim.

Grossbaum emphasized that for claims-made-and-reported policies, the covered act must occur during the policy period, claims must be made after the policy period begins and they must be reported by the covered attorney within the same policy period. Otherwise, buying liability insurance would be akin to buying fire insurance on a building that's already smoldering.

That being said, even claims made and reported during the same period can be contested by the carrier if the insured significantly delays notice in a manner that prejudices the carrier.

Moreover, even if an attorney renews the same coverage for an additional period of time, the majority rule holds that coverage would not exist for a claim made during the first period and reported during the next.

## Extended Reporting Periods

Despite the hard-and-fast rule described above, insureds were finding themselves in situations where a potentially covered act would occur or a claim would be made at the very end of a policy period and reported almost immediately, yet inevitably during the subsequent policy period.

When courts were not willing to find forfeiture of coverage in these situations, carriers began to offer extended reporting periods with their policies. These extended reporting periods are either automatic or optional. Automatic extended reporting periods extend coverage for 60 days following cancellation or nonrenewal of a policy, but only with respect to acts committed before the end date of the policy period. Optional extended reporting periods, on the other hand, are not limited in duration, yet still apply only with respect to acts committed before the end of the policy period.

The other panelists noted that these optional periods tend to be expensive, and encouraged attendees to renew policies whenever possible and avoid gaps in coverage.

To explicate the extended reporting period, Grossbaum posed additional hypotheticals to the gathered group. The key to extended reporting period coverage analysis, he said, is that the conduct giving rise to the claim cannot occur during the extended reporting period—only the claim and notice to the carrier.

For example, if a potentially covered mistake occurs before the extended reporting period, but the resulting claim and report are made after the policy is cancelled and during the extended reporting period, coverage would still be available.

## The Character of Notice

Departing a bit from strict timing issues, Grossbaum delved into the character of the notice that must be given to the carrier. Often, this is spelled out in the "Notice of Claim Provision"; it used to be dealt with in "prior knowledge" provisions.

The key language in these notice provisions is that an insured must report any act "which could reasonably be expected to be the basis of a" covered claim. If this reasonable expectation element is met, notice should be given (a) in writing; (b) by the insured; (c) to the carrier; and (d) to the carrier's claims department.

Too often, carriers see notice given by brokers and claimants to the carrier's underwriting or administra-

tive offices. These are often ineffective, much to the dismay of the insureds.

## Prior Knowledge

After a lively discussion of notice and timing, Ashmore shifted the focus to prior knowledge of acts and turned to Nona Bonanno, assistant vice president in the Professional Lines Claims Division at AXIS Insurance in Berkeley Heights, N.J.

Bonanno introduced the topic by explaining how carriers loathe insuring parties who might have claims lurking in the bushes. Again, to use Grossbaum's metaphor from earlier, this would be akin to insuring the already smoldering house.

To avoid this eventuality, carriers place prior knowledge obligations on their applicants and insureds. Typical prior knowledge language provides that coverage applies only if the insureds had "no reasonable basis to believe that the Insured had breached a professional duty or to foresee that a claim would be made" against the insured.

"Reasonable basis to believe" are the critical four words in the provision, but also the most debated. Along with insuring language directed to prior knowledge, most policies also contain a prior knowledge exclusion to buttress the requirement. These exclusions typically prohibit coverage for any claim arising out of any act committed before the policy period began if the insureds had a reasonable basis to believe the act could result in a claim.

Whether the insuring language or the exclusion is at issue, Bonanno warned attendees to carefully examine the entire policy; some policies vary in how far back applicants must report prior knowledge.

Other panelists also noted the importance of a close examination of the policy language. For example, whether the prior knowledge exclusion requires disclosure of "the" insured's prior knowledge or "an" insured's prior knowledge could make a significant difference in the degree and breadth of prior knowledge that must be reported.

In response to a question from Amanda Dudgeon, a partner at Corrigan & Chandler LLC in Charleston, S.C., the panelists agreed that even prior knowledge of paralegals can be imputed to a firm, if the paralegals are defined as "insureds" under the policy (which they usually are). In some states, firms must also speak with attorneys who are no longer with the firm in order to appropriately report prior knowledge.

Just like reporting claims, reporting prior knowledge must be similarly detailed. Commonly required elements of notice include (a) the specific error; (b) the injury or damages that have resulted, or may result, from the specific error; and (c) the circumstances by which the insured first became aware of the error.

Carriers find it inadequate for an attorney to report a troublesome client or situation; the prior knowledge must be reported with specificity. This prevents insureds from "laundry-listing" the insurer with potential problems and allows the carrier to appropriately price the risk of the attorney or firm.

To drive home the point about prior knowledge, Bonanno presented the group with four common scenarios involving insureds' obligation to report prior knowledge of a claim.

### **‘Good Client Relationship’ Scenario**

In this common scenario, the carrier has provided continuous coverage to the lawyer since 2005. In 2007, the client sends an e-mail to the lawyer blaming him for certain improper disclosures, but the client continues to use the lawyer’s services.

During the 2009-2010 policy period, however, the client sues the lawyer, and the lawyer immediately reports the claim to the carrier. The lawyer argues that he had no prior knowledge of the potential claim because of the continued representation and the good (until he was sued), continuous client relationship.

A discussion in the group yielded the result that this scenario could probably go either way and really depends on the nature of the e-mail from the client. The carrier representatives on the panel warned the lawyers in attendance to report this as prior knowledge, even if it makes the insurance more expensive, because expensive coverage is better than no coverage.

### **‘Client Has No Claim’ Scenario**

Here, the lawyer represents the client and her business partners beginning in 2010. In May 2011, the lawyer receives a letter from the client’s successor counsel alleging a potential conflict of interest in 2010. A few months later, in January 2012, the lawyer applies for insurance coverage with a new carrier, but does not report the letter from successor counsel. Seven months later, the lawyer receives a letter from the client seeking to mediate the claims in connection with the conflict of interest, which the lawyer tenders to the new carrier.

In this instance, there probably is no coverage for the lawyer. There is no continuous coverage, so the lawyer should have reported the letter as part of his prior knowledge disclosure.

### **‘I Can Fix This’ Scenario**

In this third common scenario—which lawyers replicate all the time—the carrier provides the lawyer continuous coverage beginning in 2009. In 2011, the lawyer represents the client in a medical malpractice action that is eventually dismissed on procedural grounds. Despite negative indicators from the trial court, the lawyer does not notify the carrier of this situation when renewing his policy, choosing instead to appeal the adverse ruling. The next year, the client’s appeal of the dismissal is rejected, and the lawyer notifies the carrier of the potential claim.

Despite the seemingly debatable nature of coverage in this case, most courts have been siding with carriers, holding that insureds must notify the carrier of this type of adverse ruling as prior knowledge when renewing a policy.

### **‘But We Ultimately Won’ Scenario**

As many lawyers know, the axiom “All’s well that ends well” does not always apply. In this scenario, a carrier is providing continuous coverage to the lawyer before the lawyer starts representing the client in 2010. In 2014, despite a long delay due to the lawyer’s admitted unexcused procrastination, the client’s case eventually resolves favorably. In 2015, the client sues the lawyer, right after the inception of the new policy period, claiming lost interest on the judgment due to delay.

Here, the lawyer did not notify the carrier of the prior delay when renewing for 2015, probably to the lawyer’s coverage detriment. Most courts would find coverage lacking; the lawyer should have notified the carrier of his procrastination.

## **Retroactive Dates**

Bonanno’s discussion of prior knowledge dovetailed with the final third of the discussion, led by Daniel Hirsch, a senior underwriter at Zurich Insurance in New York. Hirsch presented on the topic of retroactive date provisions and their interaction with prior acts.

Today, most policies will contain language limiting coverage to professional services that occurred either during the policy period, or prior to the policy period but subsequent to the “retroactive date.” This retroactive date, Hirsch explained, gives carriers reasonable bounds to enable them to more appropriately price risk and professional liability policies.

The panelists said that if policies covered professional services performed at any time in the past, it would be nearly impossible to appropriately price liability insurance for new customers. In addition, courts have interpreted policies silent on retroactive dates as having unlimited retroactive coverage. The retroactive date is also beneficial to the insured: it helps to cover gaps in coverage, which can be devastating to attorneys faced with a claim.

Like Bonanno, Hirsch supplemented his discussion with several hypothetical scenarios. The one that generated the most discussion addressed continuing acts and representation when the date of the wrongful act is not clear in relation to the retroactive date.

Imagine that a liability insurance policy lists March 1, 1996, as the retroactive prior acts date. The lawyer is retained by the client in early 1990 to probate her father’s estate. On Nov. 23, 1993, the lawyer obtains a judgment on behalf of the estate but fails to pursue collection. Twenty years later, on Nov. 23, 2013, the judgment is rendered uncollectible, and the client sues in January of the following year. Is there coverage?

The panel suggested that there probably is not, because the judgment could have been collected between 1993 and 1996, prior to the retroactive date.

## **Expensive Better Than Nonexistent**

The session closed with some points of importance from each panelist.

Grossbaum emphasized the difference between the retroactive date and the claims made date. Understanding them both will go a long ways in a coverage analysis, he said.

Ashmore noted that courts get as confused as lawyers with the terms and various important dates. So take the time to educate the court on the relevant definitions and the distinctions between them. Absent this education, courts may try to find ambiguity and adjudicate based on fairness, rather than the plain terms of the policy. This disposition often goes against the carrier.

In the end, all of the panelists agreed on at least one point: Communicate with your carrier and report everything. Expensive insurance is better than no insurance.