



Legal Beat

By MICHAEL SEAN QUINN

Legal Malpractice Insurance

There are a huge number of lawyers in Texas. Many of them are not very good. For every lawyer there is probably at least one paralegal. Many of them are as proficient as the lawyers they assist, though usually less learned. For generations, it has been difficult to obtain judgments of malpractice against lawyers. There are several reasons for this fact.

First, what lawyers do involves a lot of judgment. Lawyering contains a subjective, discretionary element. Consequently, if a judgment is wrong, it is not necessarily negligent. Second, lawyering involves elements of mental difficulty. Mistakes are easy to make but hard to classify as out-and-out negligence. Third, lawyers frequently make mistakes without hurting anybody. They might try a case, make a mistake in the trial of the case, but still not hurt the client. It might well be that the client was going to

lose the case anyway. Tracing causation through the thicket of social reality is not easy. Fourth, and finally, lawyers like to protect their own—for the most part. Judges are lawyers. Hence, many judgment rules are construed liberally.

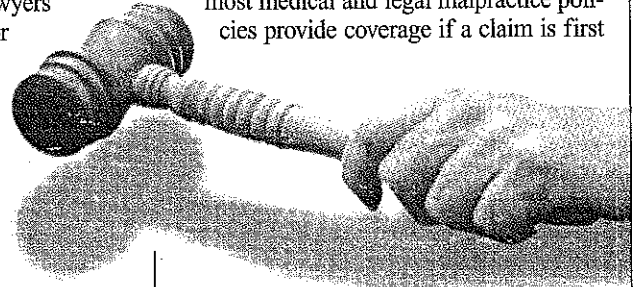
Times are changing. Lawyers are more closely watched than ever before. The client base is more sophisticated than in the past. Insurance companies are willing to put up with less nonsense and fewer recoveries of lawyers who injure them.

Since the bar is so large, it is no longer a community, and some plaintiffs lawyers virtually specialize in suing other lawyers. Consequently, the legal malpractice insurance market is an excellent one. Here is

what to expect in such contracts. Policies vary in detail, of course.

Claims-made policies

The most important thing to know about legal malpractice policies is that they are "claims made" policies, as opposed to injury policies. The CGL, the homeowners, and most excess policies provide coverage if an injury is sustained during the period of time in which the policy is in force. In contrast, most medical and legal malpractice policies provide coverage if a claim is first



made during the time interval during which the policy is in effect.

Perhaps the second-most important thing to know about legal malpractice policies is that no state has comprehensive jurisprudence construing them. Texas has only a fistful.

One recent Texas case does help under-

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stand what it is to be a claims-made policy. The policy excluded coverage for suits about which an insured knew or should have known at the point of the application. There was evidence that the individual attorney-insured knew that he was to be sued at the point his law firm applied for the policy. The court held that there was no coverage for either that attorney or for the firm.

The insuring agreement

For the most part, legal malpractice policies agree to pay on behalf of the insured all sums, above a specified deductible, which the insured shall become legally obligated to pay as "damages," including actual and additional damages assessed under the Deceptive Trade Practices Act by reason of any act, error or omission:

(a) occurring during or prior to the policy, and

(b) arising out of "professional services" rendered or that should have been rendered for others by the insured.

This obligation applies to all claims first made against the insured during the policy period and purported to the insurer during the policy period.

Notice that according to the insuring

agreement, not only the claim but the injurious act or omission must happen during the policy period. This restriction is mostly modified by endorsement, however. Typically, the endorsement extends the coverage backwards to cover earlier events if they are reported as claims only during the current policy period.

Although it does not come up very often, courts occasionally have to count the number of errors or omissions admitted by a lawyer in order to determine policy limits. In one case, there was \$250,000 in coverage per claim, and the plaintiff had argued that the lawyer committed two separate errors.

As against the insurer, the lawyer-defendant-insured argued that there was one claim for each separate error, so there was \$500,000 of insurance available. The court took the view that the lawyer's client "had one primary right—the right to be free of negligence by its attorney in connection with the particular [matter] for which he was retained. [The] lawyer allegedly breached that right in two ways, but it nevertheless remained a single right." The court "[found] it difficult to imagine how the loss of or damage to a single right could give rise to more than one claim under an attorney's professional liability policy."

The key defined terms in the insuring agreement are "professional services" and

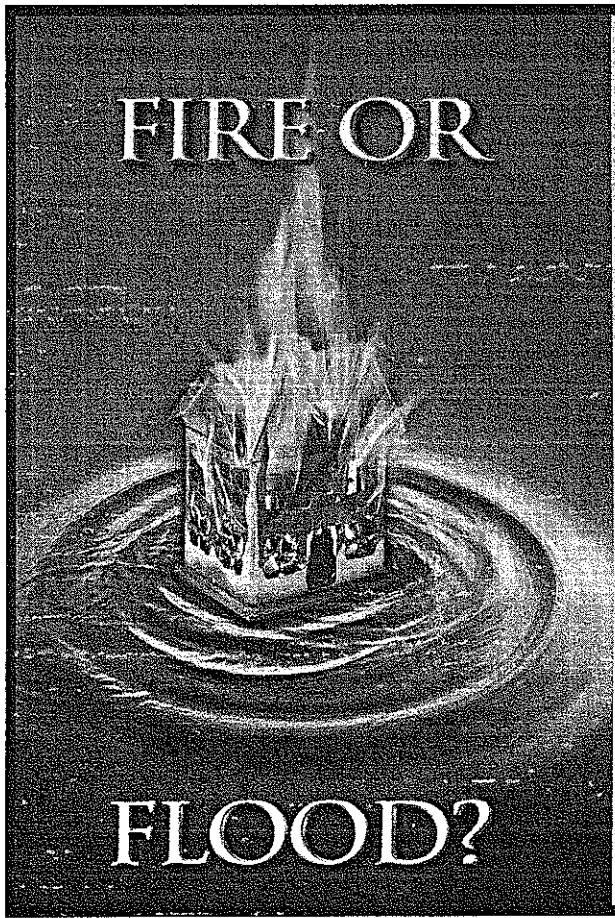
"damages." The phrase "professional services" is defined as follows:

(a) legal services performed for others as a "lawyer" or notary public services performed for others in connection with the practice of law;

(b) legal services performed for others as a "lawyer" while acting as an administrator, conservator, receiver, executor, guardian, trustee, business manager, financial consultant, escrow agent or any similar fiduciary capacities; provided, however, that the exercise of investment or business judgment in such capacities shall not be construed to be legal services;

(c) mediation and arbitration services performed for others.

The term "lawyer" means "a lawyer or any entity through which a lawyer is legally permitted to provide 'professional services,'" and the term "damages" means "a monetary judgment, award, or settlement[.]" Excluded from the term "damages" are fines, penalties, monetary sanctions, "claims expenses," mandated refunds of legal fees, alterations of agreements to charge legal fees, and so forth. Problems arising in the professional life of a lawyer



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from activities he took on his own behalf are similarly not covered, because they do not constitute professional services. Professional services must be provided to someone else.

The liability for notarial errors is important, though quaint. The problem arises when documents that must be recorded have been properly notarized and therefore can't be filed. Sometimes, a signatory has died before a document can be renotarized, and this results in lawyer liability.

Insuring agreements often obligate legal malpractice carriers to defend the insured (even when they don't, they obligate the carrier to pay for the defense.) The carrier's duty to defend is triggered by the allegations in the plaintiff's pleadings, just as it is for other liability policies. The nature of the duty to defend is somewhat different in the legal malpractice area than elsewhere. While the insurance carrier has a right to appoint defense counsel and has the right to defend the claim, the carrier is obligated to consult in advance with the lawyer-insured regarding the identity of defense counsel.

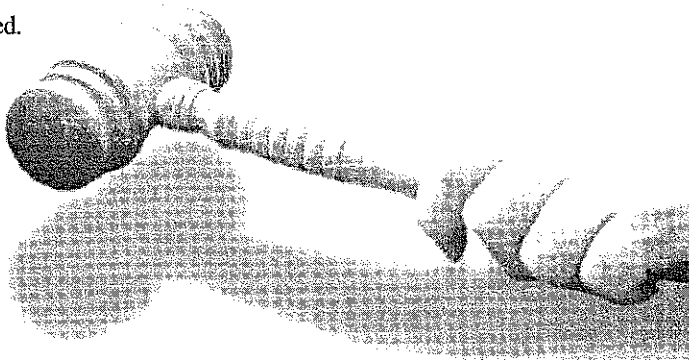
Similarly, the carrier has the right to investigate any claim and to settle it as it deems expedient. This duty is identical to the duty carriers have under CGL policies. However, in the legal malpractice arena, the carrier is obligated not to settle without con-

sulting with the insured. Under the policy discussed here, if the insured disagrees with the insurer's decision to settle, the insured has a right of appeal within the insurance company, even though the insurance company has the ultimate authority to decide whether to settle.

Some policies provide if a lawyer-insured refuses a settlement, and a judgment is returned against her for more than the settlement offer, the policy will pay no more than the amount of the settlement offer the insurer had found agreeable.

Exclusions

In general, legal malpractice policies do not apply to claims arising out of dishonest, fraudulent, criminal, malicious, or deliberately wrongful acts, errors or omissions. Some policies specifically state that all violations of RICO are excluded. Some policies provide that the carrier will furnish the attorney a defense to any claim falling within this exclusion, but also based on a theory of malicious prosecution.



The foregoing exclusion is usually the first one to be found in the exclusion section of any malpractice policy. It is similar to the "expected or intended" exclusion that is found in general liability policies. It is analogous to the concept of an accident, which is to be found in modern general liability policies.

Another exclusion found in malpractice policies coordinates that contract with the CGL policy. Thus, attorney malpractice policies, in general, exclude claims arising out of bodily injury (as that term is defined in the CGL policies) and out of property damage (as that term is defined in the CGL policies).

Virtually all legal malpractice policies exclude coverage for claims arising out of business a lawyer may conduct other than his law practice. This includes businesses for which the lawyer serves as a director. (Directors and Officers Liability Insurance covers such activities.) The exclusion also denies coverage to the business activities of an entity that a lawyer-insured controls, operates, or manages as a fiduciary. Moreover, if the insured lawyer serves as a public official, a fiduciary under ERISA, a broker, dealer, investment advisor, accountant, or a real estate broker, those activities are not covered under a legal malpractice policy.

Sometimes, these exclusions are troublesome. Notice that the definition of "professional services" includes some business manager functions. Drawing the line between covered functions and excluded functions can sometimes be difficult.

Business disputes among lawyers who are in business together, or legal disputes between a lawyer-insured and some other business associate, are not part of a legal malpractice policy. Similarly, controversies arising out of the dissolution of a law firm are not covered, unless they relate to the lawyer-insured's representation of one or more clients prior to the dissolution of a law firm. Obviously, these are business risk exclusions analogous to exclusions that may be found in other liability policies. Along with these exclusions, there is no coverage

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for claims seeking reinforcement of indemnity agreements into which an insured entered without obtaining the prior written approval of the carrier.

Contemporary legal malpractice policies frequently exclude liability for court ordered sanctions. Similarly, some modern liability policies exclude coverage for liability assessed in the grievance process. Sometimes, grievance committees order (or suggest) that lawyers make payments to aggrieved persons. Sometimes, these orders are in lieu of suspensions, or in lieu of lengthy suspensions. In any case, there is no

coverage for this sort of liability.

Some modern liability policies exclude liability for punitive damages, as well as liability for restitution, statutory fines and multiple, and the like. Some policies exclude coverage for mental anguish or emotional distress. Some policies exclude coverage for claims based upon unlawful discrimination, such as "discrimination on the basis of race, national origin, creed, religion, age, sex, or marital status."

Legal malpractice policies most often come into play when clients sue their lawyers. Indeed, as a matter of tort law, in

many states, only clients may sue their lawyers. In other states, those in near privity with a lawyer may sue, such as intended third party beneficiaries. Professional liability insurance policies designed for attorneys are much broader than simply insuring against the tort of attorney malpractice. Such policies may respond to all kinds of claims brought against the attorney. Claims by opponents, employees, purchasers of securities, beneficiaries of welfare plans, referring attorneys, and others may also come into play.

Other provisions

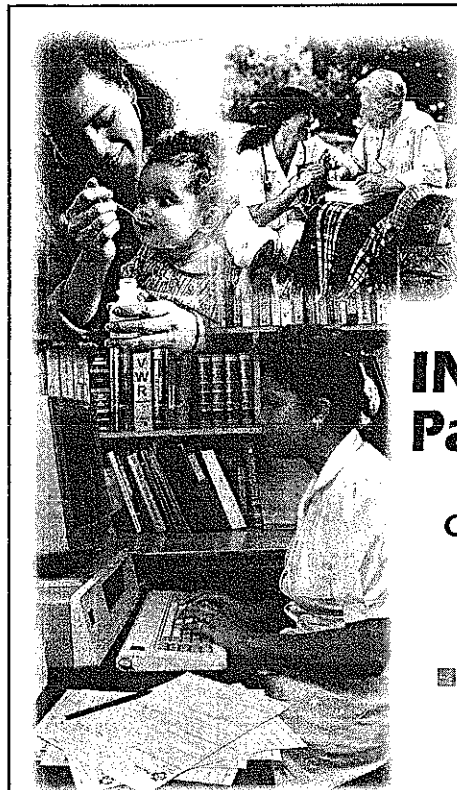
As a general rule, professional liability policies contain "other insurance" clauses that specify that the insurance shall be excess with respect to other insurance. It is not unheard of, however, for legal malpractice policies to contain pro rata "other insurance" clauses. When two malpractice policies are both applicable, both may be required to participate pro rata.

As with other liability insurance policies, the insured has an obligation to give prompt notice of a claim as well as the obligation to give the insurer notice of a suit as soon as practicable. In addition, insureds must notify carriers regarding errors of omission about which they come to be aware, even if no claim is filed. If an insured provides such a notice, the contract requires that the carrier recognize that a claim has been made as of the date of the notice from the insured.

Naturally, lawyers' professional liability policies contain expansive cooperation clauses. Acting in accordance with these cooperation clauses is extremely important. If an insured fails to conform to a cooperation clause, it can find coverage avoided. Under most circumstances, insureds should bend over backwards to provide insurers with pertinent information. This can be quite onerous in insurance policies that insure ongoing services. The insured may have to review substantial files with the insurer.

Most modern professional liability policies are "wasting policies." This means that the legal expenses paid by the carrier in defending suits brought against the lawyer-insured are deducted from the policy limit. Wasting policies make it extremely difficult to settle lawsuits against insureds for a sum certain. The use of such policies also make it difficult to formulate and submit "Stowers Demands" for a sum certain. ■

Quinn is an Austin shareholder in the law firm of Sheinfeld, Maley & Kay. He litigates and testifies on insurance-related problems and is currently the chair of the Insurance Section of the State Bar of Texas. He also is a Visiting Professor of Law at the University of Texas-Austin.



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