

Lawyers' Professional Liability Insurance

Purchase and Coverage Issues

BY MICHAEL R. MCCORMICK

Whoops! Imagine being sued or grieved and discovering you don't have insurance to pay your defense or the judgment entered against you. You could lose your savings, your home, and other significant personal assets. You might even have to file for bankruptcy.

Every attorney who practices privately must decide whether to purchase lawyers' professional liability insurance (LPLI), and if so, which policy to buy. But the topic of liability insurance is not taught in law school, and most lawyers know very little about the industry. When presented with options, many lawyers (and certainly young lawyers) don't understand the basic terms of the policy or know anything about the financial status of the company they are buying the policy from. Terms like "claims made and reported" and "exclusions" are foreign phrases. Often, lawyers will simply purchase the absolute cheapest policy they can find. This is a bad business practice, because the cheapest policies usually have inadequate coverage and unfavorable terms for the lawyer.

This article discusses some common issues regarding LPLI.¹ It is not intended to discuss insurance law or provide legal advice. Lawyers are advised to consult more in-depth treatises regarding LPLI that may be applicable to their individual situation.²

Should I Buy LPLI?

Practicing law without LPLI is dangerous—akin to not having health insurance, car insurance, or homeowners insurance. The Colorado Rules of

According to the Colorado Supreme Court, a staggering 15% of Colorado lawyers in private practice do not carry LPLI. But any attorney, at any time, can be the subject of a large malpractice claim or be forced to respond to an investigation from the Colorado Office of Attorney Regulation Counsel.

Professional Conduct restrict our ability to limit our own liability to our clients.³ If you believe you have LPLI through your PC or LLC, you are wrong. If you practice without LPLI, then you are putting your home, your automobile, and everything else you have at risk.

According to the Colorado Supreme Court, a staggering 15% of Colorado lawyers in private practice do not carry LPLI.⁴ But any attorney, at any time, can be the subject of a large malpractice claim or be forced to respond to an investigation from the Colorado Office of Attorney Regulation Counsel (OARC). As we attorneys know, just the cost of defending against a lawsuit can be several hundred thousand dollars or more, not including the liability for the claim itself. Are you prepared to pay for that out of your own pocket if you do not have LPLI?

CRCP 227(c) requires all attorneys in private practice to disclose whether they carry LPLI. This information is available to the public on the Colorado Supreme Court's website.⁵ Notably, the Court encourages the public "to discuss the issue of malpractice coverage with [their] lawyer."⁶ Thus, you should always be prepared to field questions from clients or potential clients about your malpractice insurance. In addition, consider checking the Court's website before referring clients to other attorneys, because it could be deemed malpractice to refer a case to a lawyer who does not carry LPLI.⁷

Eroding Limits Policies

An "eroding limits" policy means that the amount of liability coverage decreases dollar for dollar as defense costs are incurred; it is said the defense costs are "inside" the policy. For example, if you have \$1 million in coverage and the attorney fees and costs for defending a claim are \$500,000, only \$500,000 would remain in liability coverage to pay any settlement on the claim. These policies are cheaper to buy (i.e., the premium is less expensive) because there is less exposure for the insurance company and more exposure for the lawyer. However, they can cause serious coverage problems. For example, if your liability coverage is \$100,000 and a \$500,000 claim is asserted against you, defense costs will quickly eat up your coverage, with nothing left to cover the \$500,000 in potential liability. That means the claimant may eventually pursue your personal assets.

Eroding limits policies also invite conflicts with your insurance company. If the claim greatly exceeds coverage, should you and your

insurance company emphasize a strong (and expensive) defense? Or should you do as little as possible to preserve the minimal amount of coverage you do have? What if you and the insurance company disagree on these issues?

The best way to avoid these problems is not to purchase eroding limits policies. However, they have become more and more commonplace. If you do buy one, make sure the policy has a large amount of liability coverage.

The “Hammer Clause”

Usually the insurance company does not have the right to settle a claim without your consent. However, many policies have a “hammer clause” stating that if the lawyer does not consent to a proposed settlement at an amount approved by the plaintiff, but the insurance company wants to settle for that amount, then the insurance company’s liability is limited to the amount for which the claim could have settled, plus defense costs incurred up until the day the lawyer refused to settle. Although these provisions are rarely invoked, they can come into play during settlement negotiations and could result in personal liability for you.

Cyberliability Coverage

Cyber-related legal malpractice claims are on the rise. Sometimes these result from outside hackers, but they can also result from internal hacks by “rogue” employees. Most LPLI policies do not include cyberliability coverage or offer only minimal protection. You should strongly consider buying a standalone policy or supplemental coverage on your existing policy to adequately protect against cyberliability.

You should also carefully consider what affirmative steps you and your firm are taking to avoid cyberliability. Think about what will happen if a hacker steals your client’s information or you lose your laptop at the airport with your client’s files on it. If a claim arises, you will have to answer hard questions about what steps you and your law firm took to protect the information, what security measures you had in place (including password protection), what training you and your employees had, and whether you complied with cybersecurity laws and regulations, such as Colorado’s new

cybersecurity law.⁹ It’s best to take proactive measures now, before an incident occurs.

Another common sense measure is to have a response plan in place. If a cybersecurity incident occurs, how will you inform your client(s) and comply with cybersecurity laws?⁹ What steps will you take to avoid further security breaches? When and how will you inform your

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insurance company? How you respond can be critical to minimizing the damage and maintaining the viability of your business.

Other Coverage Considerations

According to a 2017 survey by Ames & Gough, the number of new legal malpractice claims brought against law firms is stabilizing but historically has demonstrated an upward trend.¹⁰ Conflicts of interest are perhaps the most common alleged legal malpractice error. Carefully checking for conflicts of interest and obtaining adequate conflict waivers are critical to avoiding claims.

Many conflicts of interest claims are based on lateral hires.¹¹ Too often lateral hires are inadequately screened for conflicts. Sometimes, even when conflicts are discovered, they are brushed aside and ignored. That can result in extremely costly claims.

Other common practice areas with higher numbers of claims are business transactions (such as mergers and acquisitions), corporate and securities law, probate law, and trusts and estates.¹² Buying policies that cover these areas may be more expensive, but nevertheless necessary. Be sure to carefully examine whether your practice areas are covered by your LPLI policy. For example, many insurance companies exclude or do not cover certain practice areas, such as securities law. In that case, you may need to buy a special policy.

Generally LPLI policies are “claims made” policies, in contrast to “occurrence” policies. Under a “claims made” policy, coverage depends on when the claim is made and reported to the insurer, not when the claim actually occurred. However, the policy may have an exclusion for an event that occurred before the first day of the policy coverage period. In that case, consider buying “prior claims” coverage. You may also want to buy a “tail policy” for claims that are made after the policy terminates. Always make sure you have adequate coverage in place for all time periods, no matter when the event triggering the claim occurred (i.e., avoid any gaps in coverage).

Coverage issues can also become important when changing law firms or upon retirement. If you change law firms, make lateral hires, or are about to retire, carefully examine the applicable LPLI policy (or policies) to make sure you are covered during the transition, and consider purchasing additional coverage if necessary.

LPLI typically covers legal malpractice in rendering legal advice and providing professional legal services, not other types of acts. So, for example, it usually does not cover dishonest, fraudulent, or malicious acts, comingling client funds, intentional torts, physical injuries to your employees, criminal acts, and so on. Lawyers’ business ventures and entrepreneurial activities with clients are also typically excluded under LPLI policies.

Want to invite a lawsuit against you for legal malpractice? One surefire way is to sue your former client for unpaid attorney fees. The former client will often assert a counterclaim for legal malpractice.

Claims for Fee Disputes and Unpaid Attorney Fees

LPLI policies typically exclude coverage for attorney fee disputes and have exclusions for paying your unpaid attorney fees. Not surprisingly, if your former client does not want to pay your attorney fees related to your former representation, your insurance company does not want to pay them either.

Want to invite a lawsuit against you for legal malpractice? One surefire way is to sue your former client for unpaid attorney fees. The former client will often assert a counterclaim for legal malpractice. Instead, consider taking some proactive steps now. Seek a retainer at the outset of the representation adequate to cover several months of work before you begin. If your client stops paying her bills, then promptly call her to see what is going on. This will alert you to a problem sooner rather than later. Also, put

a provision in your engagement letter giving you the right to promptly withdraw for cause if your invoice is not timely paid. These situations cannot always be avoided. However, taking these steps now may help you avoid racking up a huge unpaid bill.

Report Claims Early

Most LPLI policies include a deadline for reporting claims within a certain time period. Make sure you comply with any such deadlines or you may be excluded from coverage. When in doubt, promptly report a potential claim to your insurance company. Although your premiums could rise or your policy may not be renewed, that is better than being excluded from coverage with respect to an expensive claim that you cannot afford to pay on your own.

Choice of Counsel

If you are sued for legal malpractice, you will want the best available lawyer, so try to have as much input as possible on who will represent you. Most insurance companies have a panel of counsel available to defend lawsuits. While some policies require the insurance company to select the lawyer, others allow you to select from the panel.

Disciplinary Coverage

What if you are grieved by a client? Does your LPLI policy cover you? Many LPLI policies have coverage available for you to hire a lawyer to respond to the OARC. Some lawyers make the mistake of responding to the OARC themselves without hiring a lawyer. That is not a good idea. Inevitably your emotions will get the best of you and you will not present your best self to the OARC.

Choosing the Right Insurance Company

Not all insurance companies are equal. If a claim is made against you, will the insurance company fulfill its promises and pay your defense costs? Will the insurance company be able to pay to settle the claim? The more reputable, experienced, and financially stable the insurance company, the more likely it is to deliver on its promises. It is a good idea to

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If you are sued for legal malpractice, you will want the best available lawyer, so try to have as much input as possible on who will represent you.

check the insurance company’s A.M. Best Company rating.¹³

Insurance companies also vary widely in their ability to manage legal malpractice claims. Some are heavily experienced in managing legal malpractice claims and others have almost no experience at all. Needless to say, companies with little experience managing legal malpractice claims are not a great choice for you.

The flip side of these considerations is price. Typically, but not always, the better the insurance company, the more expensive the policy. If your policy is cheap, this is a red flag that the insurance company may not be very good. Or the insurance company may be reputable, but the policy terms may be so lacking that they provide very little coverage and protection. On the other hand, sometimes reputable insurance companies offer special introductory rates on premiums for sound policies. Always read the specific policy terms to know what you are buying.

Where to Get Help

The Colorado Bar Association assists its members by educating them about LPLI. CBA members are encouraged to visit the CBA’s website for more information.¹⁴ 



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NOTES

1. For more information on LPLI, see Little, “Lawyers’ Professional Liability Insurance: Why You Need It and Where to Get It,” 46 *Colo. Law.* 79 (Feb. 2017).
2. For more detailed information regarding purchase and coverage issues for LPLI, see the ABA Standing Committee on Lawyers’ Professional Liability website at www.americanbar.org/groups/lawyers_professional_liability/resources/risk_management_resources.html, and Mallen, *Legal Malpractice: The Law Office Guide to Purchasing Legal Malpractice Insurance* (Thomson Reuters 2019).
3. See, e.g., Colo. RPC 1.8(h) (“A lawyer shall not . . . make an agreement prospectively limiting the lawyer’s liability to a client for malpractice unless the client is independently represented in making the agreement . . .”).
4. See, e.g., Colorado Office of Attorney Regulation Counsel 2017 Annual Report at 62-82, www.coloradosupremecourt.com/PDF/AboutUs/Annual%20Reports/2017%20Annual%20Report.pdf.
5. See the Attorney Search and Disciplinary History page on the Colorado Supreme Court’s website, www.coloradosupremecourt.com/Search/AttSearch.asp.
6. See www.coloradosupremecourt.com/PDF/Complaints/A%20word%20about%20professional%20liability.pdf.
7. See CJI-Civ. 15:23 (2019) (Referral of Client to Another Attorney) (referring attorney who fails to exercise reasonable care in selecting another attorney may be held responsible for her own negligence).
8. On September 1, 2018, Colorado enacted HB 18-1128 (codified at CRS §§ 6-1-701 et seq.), which strengthened protections for consumer data privacy. The new law includes requirements for storing and protecting client data and notifications for security breaches.
9. Colorado’s new cybersecurity law includes requirements to notify affected individuals of a data breach and to notify the Colorado Attorney General’s Office under certain circumstances.
10. See Ames & Gough News Release, “Legal Malpractice Claims Stabilize, But Remain Above Pre-Recession Levels” (June 28, 2017), www.amesgough.com/sites/default/files/AG%20News%20Release%20-%202017%20LPLI%20Claims%20%20Survey%20-%2006-28-17.pdf.
11. *Id.*
12. *Id.*
13. See www.ambest.com.
14. The CBA’s Lawyers Professional Liability Committee provides educational resources on LPLI, improving the quality of legal practice, and avoiding legal malpractice claims. For more information, visit the Committee’s website at www.cobar.org/For-Members/Committees/Lawyers-Professional-Liability-Committee.

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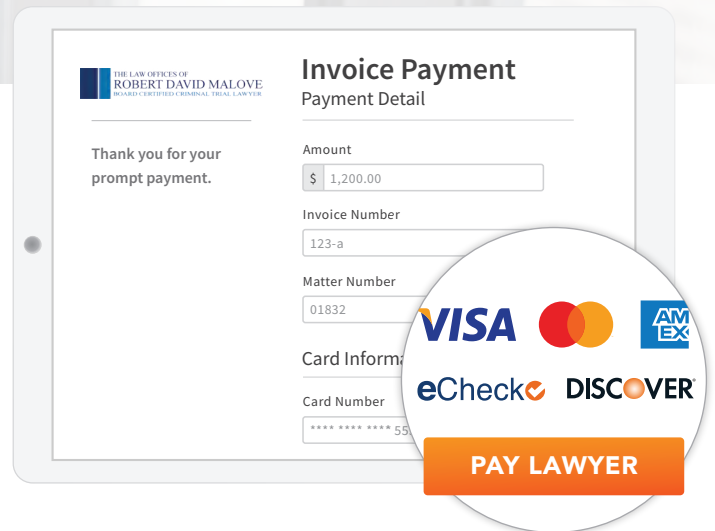
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