PURCHASING LEGAL MALPRACTICE INSURANCE:
THE FORM MATTERS!

NANCY R. KORNEGAY
DAVID H. BROWN
Brown & Kornegay LLP
2777 Allen Parkway, Suite 977
Houston, Texas 77019

State Bar of Texas
21st ANNUAL ENTERTAINMENT LAW INSTITUTE
October 20-21, 2011
Austin

CHAPTER 3
Nancy R. Kornegay
Brown & Kornegay L.L.P.
2777 Allen Parkway, Suite 977
Houston, Texas 77019
713.528.3703 (office) 713.528.3701 (facsimile)
Email: nkornegay@bkllp.com  Web site: www.bkllp.com

Professional Employment:


Listed:

- “Rising Star” in Insurance Law, Texas Monthly, 2010-2011

Education:

- University of Houston, 2001, J.D., with honors. Editor in Chief, Houston Law Review.
- University of Houston, 1997, B.S., summa cum laude

Memberships:

- State Bar of Texas (2001); American Bar Association; Houston Bar Association

Representative Publications and Presentations:

- Directors and Officers Insurance Application Issues, ABA TIPS Conference, Tucson, Arizona 2011
TABLE OF CONTENTS

INTRODUCTION .......................................................................................................................................................... 1
I. THE TEXAS LPL INSURANCE MARKET ......................................................................................................... 1
II. WHETHER TO PURCHASE LPL INSURANCE ................................................................................................. 2
III. KEY STRATEGIC DECISIONS IN PURCHASING LPL INSURANCE ........................................................... 2
   A. The “Claims Made” Trigger of Coverage ............................................................................................... 2
   B. Coverage for “Prior Acts” ........................................................................................................................... 3
   C. Extended Reporting Period – “Tail” Coverage ........................................................................................... 3
   D. Applications for LPL Insurance – Disclosing Potential Claims .............................................................. 3
   E. Notice and Reporting Requirements ....................................................................................................... 5
   F. Circumstance Notice ................................................................................................................................. 6
   G. Coverage of Defense Expense .................................................................................................................. 7
IV. THE INSURING AGREEMENT, POLICY EXCLUSIONS, AND OTHER COVERAGE LIMITATIONS ...... 9
   A. What Conduct is Covered? ......................................................................................................................... 9
   B. Whose Conduct is Covered? .................................................................................................................... 11
   C. Exclusions and other Coverage Limitations ............................................................................................ 11
BIBLIOGRAPHY ......................................................................................................................................................... 13
PURCHASING LEGAL MALPRACTICE INSURANCE — THE FORM MATTERS!

INTRODUCTION

Much of the available literature on legal malpractice insurance — formally referred to by the insurance industry as Lawyers’ Professional Liability or “LPL” coverage — is not always helpful for purposes of purchase decisions. This is especially so for solo practitioners or small firms that may not use large insurance brokers and that may lack in-house insurance coverage expertise. Even for firms having such expertise, the available resources tend to present lists of coverage issues and potential policy components, rather than an analysis of the key strategic issues posed by LPL policies.

This paper is intended to address the pragmatics of purchasing LPL coverage. It begins with a summary description of the Texas LPL market, comments briefly on intangible factors bearing on the interplay among four coverage issues of strategic importance – the “claims made” coverage trigger, the “prior acts” issue, problems posed by LPL applications, and the “circumstance notice” issue. The paper then concludes with a summary of other important LPL policy terms and coverage limitations.

The thesis of this paper is that the cumulative impact of nuanced differences in the wording of alternative LPL policies counsels against procurement decision-making based predominantly on price.

I. THE TEXAS LPL INSURANCE MARKET

Texas does not regulate LPL insurance. As a result, there is no standard policy form, as is the case of regulated lines of coverage, such as general and automobile liability insurance. Regulated lines often utilize forms promulgated by the Insurance Services Office or “ISO” and are commonly used nationwide. LPL policies, on the other hand, contain some common elements and uniformly insure liability arising from the practice of law, but vary materially from insurer to insurer. Any given insurer’s form may be endorsed to expand or contract the coverage provided by the form.

The LPL market in Texas is reasonably diverse, offering multiple but materially different options — both in terms of the scope of coverage and pricing — for law firms of different sizes. Currently, between 25 and 30 different insurers write LPL policies for Texas lawyers.1 Some are large, well known domestic insurers, such as Chartis, CNA, Executive Risk, and Travelers. Others are industry mutuals, owned by their insureds, that underwrite policies on a direct basis, without a broker as an intermediary. These include Attorneys’ Liability Assurance Society, Inc. (“ALAS”), which insures most of the large law firms in Texas, and Texas Lawyers’ Insurance Exchange (“TLIE”), which insures 1,200 Texas firms, including many solo practitioners, as well as small and intermediate size firms.

LPL insurers have differing underwriting criteria, which typically state minimum or maximum law firm sizes. A minimum firm size might be as small as 2 or 3 attorneys or as many as 75 or 100 attorneys. Maximum sizes can range from as few as 10 attorneys to firms having several hundred attorneys. There are similar ranges in the amount of available deductibles ($1,000 to $100,000, depending on firm size) and maximum available policy limits.

For small law firms, purchasing LPL insurance directly from an insurer, without the use of a broker, is a viable option. Many LPL insurers maintain websites, allowing prospective insureds to obtain applications and, occasionally, specimen policy forms. Examples include Chartis,2 CNA,3 and TLIE.4 Others, such as Travelers, write only through an agent or broker.

For midsize and large firms confronting a more complex array of market options, engagement of a broker is probably essential, except in the case of the industry mutuals that write directly, such as ALAS.

The pricing of LPL insurance is driven by quantitative and qualitative factors bearing on the insurer’s risk of incurring a loss and on pricing trends in the LPL market. Key objective, quantitative factors include the size of the firm, and the amount of the limit of liability and deductible. The mutual insurers generally use a “unitary” pricing matrix, reflecting the same premium per lawyer for a given policy limit and deductible. The commercial market, by contrast, assesses or “underwrites” each applicant and quotes different levels of premium based on each applicant’s perceived risk profile. Factors bearing on the risk of LPL claims commonly include the location and size of the firm’s offices, practice areas or

---

1 See Ronald E. Mallen, Legal Malpractice: The Law Office Guide to Purchasing Legal Malpractice Insurance (2011 Ed. West) at 283-84; ABA directory of insurers that write LPL insurance in each state, available at

4 http://www.tlie.org/.
specialties, the history of claims and disciplinary actions, and the perceived quality of the firm’s management and loss-prevention efforts.

As in the case of other insurance lines, the LPL market reflects pricing differences driven by competitive considerations. Periods of increasing and falling premiums are referred to as “hard” or “soft” markets, respectively. Limitations in the available breadth of coverage, particularly a new insurer’s unwillingness to offer unlimited coverage for prior acts, may give incumbent insurers the ability to raise prices, particularly during hard-market conditions.

There is a trade off between price and the breadth of coverage. The extent, however, to which this is the case is difficult to assess due to the number of qualitative factors impacting an insurer’s pricing decisions. For large and small firms, the market will present materially different options, both in terms of an insurer’s standard form and available endorsements.

II. WHETHER TO PURCHASE LPL INSURANCE

Texas lawyers practicing in limited liability partnerships are required to carry professional liability insurance, with a minimum limit of $100,000, if they do not set aside this amount to satisfy judgments. Section 152.804, TEX. BUS. ORGANIZATION CODE. Otherwise, Texas lawyers are not required to carry LPL insurance or to inform their clients that they do not carry LPL coverage.

The disclosure issue has been a subject of some controversy. In June 2008, a State Bar Task Force voted 6 to 5 to recommend that no disclosure be required of Texas lawyers. The pro and con arguments on the disclosure issue are reflected on the State Bar’s website.\(^5\) In early 2010, the State Bar’s Board of Directors, after conducting a poll of Texas lawyers, voted 39-to-1 against a disclosure requirement. The Texas Supreme Court then announced that the State would “retain the status quo” on this issue, although 26 states have adopted the ABA Model Rule in favor of disclosure.\(^6\)

Some clients and lawyer referral services require LPL insurance, although this is not the norm. Midsize and large firms invariably carry LPL coverage, while many solo practitioners and small firms do not.

Aside from the obvious protection against financial loss, the benefits of carrying LPL insurance include important intangibles, including loss-prevention services and LPL claims-handling experience. Loss-prevention services offered by LPL insurers range from elaborate, detailed reviews of firm procedures and seminars to written “best practices” and claim avoidance materials and website resources. Similarly, some of the more prominent LPL insurers have developed significant expertise in the defense of LPL claims, including, for example, claims supervision by attorneys, in-depth knowledge of potential expert witnesses and substantive legal issues, as well as experience in defending different categories of claims.

III. KEY STRATEGIC DECISIONS IN PURCHASING LPL INSURANCE

Key points bearing on the decision to purchase LPL insurance are the facts that it is almost invariably written on a “claims made” basis and is subject to limitations of coverage for so-called “prior acts.” These policy characteristics bear materially on the timing of a lawyer’s decision to purchase LPL coverage, and the steps required to keep it in force and to trigger the coverage in the event of a claim or potential claim. This section highlights the most important attributes of LPL insurance and the key strategic issues to consider in comparing policies.

A. The “Claims Made” Trigger of Coverage

Like most other professional or “errors and omissions” liability insurance, LPL policies are generally written on a “claims made” basis, meaning that the policy covers claims made during the policy period – almost invariably one year – regardless of when the conduct or incident giving rise to the claim occurred. By contrast, policies covering bodily injury and property damage are generally written on an occurrence basis, and are triggered by the fact of injury or damage within the policy period. As a result of this date-of-injury coverage trigger, occurrence policies are “evergreen” in the sense that they will cover injury or damage occurring in the distant past, assuming the absence of some other coverage limitation.

Claims-made policies, on the other hand, expire entirely at the end of the policy period or a short grace period thereafter, unless the insured has purchased an “extended reporting period” for additional premium. “Claim” is typically defined in these policies to include a written demand for monetary relief.

Coverage under claims-made policies is triggered by one of two events:

- the fact of the making of a claim; or
- the insured’s giving a “notice of circumstance” that may give rise to a claim or claims in the future.

---


\(^6\)Comments on the State Bar’s website on this issue are at http://www.texasbarcle.com/CLE/site/LawOfficeMgmtPracticeMaterials/tile.pdf.
In either case, the claim must be made, or the notice of circumstance given, within the policy period or a short grace period thereafter. An LPL claim based on acts or omissions before the inception date of the current policy would be covered under the current policy, assuming that no “prior acts” limitation applied.

As a result of the claims-made nature of LPL coverage, lawyers are obliged to purchase coverage currently, and in future years, so that claims based on conduct during prior policy periods will be covered. This fact, in conjunction with the difficulty of obtaining unlimited prior acts coverage, tends to discourage changes in insurers and to result in long term relationships between insured and insurer.

B. Coverage for “Prior Acts”

Assessing the extent to which an LPL policy covers “prior acts” is a key element of purchase decision-making. “Prior acts” refers to actionable errors or omissions occurring before a specified date, often the effective date of the first LPL policy purchased from the current insurer. In their most extreme form, “prior acts” limitations require that the act of malpractice occur in the policy period, thus precluding any possibility of coverage for prior acts. More commonly, prior acts are covered only after a specific date, stated in the policy, often called the “retrospective date.” Thus, for example, the successive policies written by an insurer for an insured may well cover only claims based on conduct after the effective date of the first policy written by that insurer. Even where the policy provides some coverage for prior acts, as a practical matter, the prior acts coverage will be from a stated “retrospective date,” meaning a date before which no conduct is covered.

“Prior acts” limitations in LPL policies arguably create a purchasing imperative. Lawyers are susceptible to “long tail” professional liability exposure due to the rules tolling the running of limitations in legal malpractice cases. As a result, the decision not to purchase current LPL coverage may, as a practical matter due to the prevalence of “prior acts” limits, mean the lawyer has no future option to purchase insurance protection for past conduct.

A similar dynamic may apply in the case of LPL insurance if the insured switches from one LPL insurer to another. In that case, it is possible – perhaps likely – that the new insurer will decline to provide “prior acts” coverage from the effective date of the first LPL policy, resulting in the loss of coverage for all or some prior acts. This fact counsels careful decision making in a lawyer’s initial purchase of LPL coverage.

C. Extended Reporting Period – “Tail” Coverage

LPL coverage written by a given insurer may come to an end either as a result of cancellation or, more commonly, non-renewal upon policy expiration. LPL policies might be non-renewed for various reasons, including, for example, the closing of a firm, retirement of a practitioner, or a firm’s decision to switch to a different insurer. In the former instance, or where the new insurer will not write satisfactory prior acts coverage, the firm or lawyer would be required to purchase supplemental, “extended reporting period” coverage in order to maintain coverage for claims made after policy expiration arising from pre-expiration conduct.

An “extended reporting period,” termed an “ERP” or “tail coverage,” refers to a provision contained in LPL policies giving the insured the right to report claims for a specific period of time after the end of a policy period. ERP clauses require the payment of an additional premium and apply only if the conduct giving rise to the claim occurred before policy expiration. The particulars of ERP provisions, including the amount of additional premium, the duration of the period or “tail,” and limitations on the insured’s ability to purchase an ERP, vary dramatically from insurer to insurer.

D. Applications for LPL Insurance – Disclosing Potential Claims

The beginning point in purchasing LPL insurance is to complete and submit an application. The degree of detail required by LPL applications tends to be proportional to the size of the firm, the scope of its specialized practices, and the number and location of branch offices. For midsize and large firms, detailed information as to existing LPL claims and loss-prevention programs may be required. Most LPL applications provide that factual changes between the date of the application and the date of policy inception must be promptly reported to the insurer, and that the insurer may modify the terms of the proposed coverage.

As in the case of any insurance application, errors or misstatements in the application may give rise to a coverage defense, which might take the form of the

---

7 The statute of limitations for legal malpractice claims in Texas is two years. TEX. CIV. PRAC. & REM. CODE § 16.003; Willis v. Maverick, 760 S.W.2d 642, 644 (Tex. 1988). A malpractice claim accrues when facts come into existence that authorize a claimant to seek a judicial remedy. Apex Towing Co. v. Tolin, 41 S.W.3d 118, 120 (Tex. 2001). The running of limitations in legal malpractice cases is, however, often tolled under either of two exceptions. Under the so-called “discovery rule,” a cause of action does not accrue until the plaintiff knows or should know of the injury. Id. at 120-21. Alternatively, in the context of litigation, the statute of limitations is tolled until all appeals have been exhausted. Id. at 119.
assertion of an exclusion of coverage or, less frequently, an attempted rescission of the policy. As a practical matter, because of the sophistication of LPL applications and policy forms, coverage exclusions based on incorrect statements or omissions in the application pose a greater threat to the insured than a claim for rescission or common law remedies,\(^8\) such as fraud in the inducement.

The most important and difficult LPL application issue concerns questions as to prospective future LPL claims. Just as insurers writing on an occurrence basis seek to avoid coverage for injury and damage that are expected to occur during the policy period, LPL insurers seek to avoid covering LPL claims that are anticipated. Although this issue is addressed under some policy forms by exclusion, more commonly the issue is addressed in the application for the insurance.\(^9\)

Determining exactly what constitutes an anticipated or potential claim for purposes of an LPL insurance application can be problematic. In this context, the specific wording of the question posed by the application, as well as the wording of any prior-knowledge exclusion, is key. Two fairly typical but alternative versions of application questions addressing anticipated claims follow:

- After inquiry of all persons to be insured under the policy, does any person know of any claim or act, error, or omission that could result in a claim against the firm or any person to be insured? Answer: __ Yes; __ No.
- After inquiry, is any attorney to be insured under the proposed policy aware of any actual or alleged act, omission, or circumstance that an attorney would recognize might reasonably be expected to result in a claim being made against the firm or any attorney associated with the firm. Answer: __ Yes: __ No.

The merit of a potential claim is irrelevant for purposes of such questions,\(^10\) which are typically followed by a request for the details of any matter prompting an affirmative answer. If the insurer proceeds to offer coverage, notwithstanding the disclosed matter, it typically insists upon endorsing the policy to exclude the matter disclosed.

Although the questions above seem similar, and are arguably ambiguous, the case law in the directors and officers ("D&O") insurance context suggests that they pose different substantive questions. The first question — inquiring as to the insured’s knowledge — probably poses a subjective test as to whether the insured subjectively appreciated the potential for a claim.\(^11\) The second question — inquiring as to what an attorney would reasonably expect — probably poses an objective, “reasonable person” standard.\(^12\) Based on the wording of the question at issue, some courts have imposed a hybrid, two-part test.\(^13\)

In the case of some errors-and-omissions liability insurance — particularly directors and officers insurance written for large corporations\(^14\) — the policy applications often provide that the insurer’s remedies for misstatements in the application are “severable” as to certain categories of insureds. Such provisions are rare in the context of LPL coverage. Instead, LPL applications commonly require “inquiry” or polling of all firm attorneys, and sometimes former attorneys or

\(^8\) The most recent Texas Supreme Court opinions addressing the common law requirement for insurance policy rescission are Union Bankers Ins. Co. v. Shelton, 889 S.W.2d 278 (Tex. 1994) and Mayes v. Massachusetts Mut. Life Ins. Co., 608 S.W. 612 (Tex. 1980). Statutory provisions limiting an insurer’s ability to rescind appear in Chapter 705 of the TEXAS INSURANCE CODE.

\(^9\) See Westport Ins. Corp. v. Atchley, Russell, Waldrop & Hlavinka, LLP, 267 F. Supp.2d 601, 608 (E.D. Tex. 2003) (if the attorney knew, prior to the policy period, that his client intended to bring a claim, even if the wrongs alleged were wholly imaginary, the policy would provide no coverage).


employees, as to whether they have knowledge of potential claims.

LPL insurers invariably require insureds to submit renewal applications toward the end of each policy year. An LPL insurer renewing on the same terms arguably has little need to repeat questions asked in an original application as to potential, unreported future claims because the insurer presumably would cover the claim if it was reported currently by a “circumstance notice.” Insurer practice varies on this issue, however. Many require renewal applications addressing potential future claims.

Where renewal applications inquire as to potential, unasserted claims, the insured has no option but to make inquiry, identify such claims, and, if possible, give circumstance notices attaching coverage in the current year as to such matters. Otherwise, if the potential claim is not identified and noticed to the current insurer, the insured risks a coverage defense under the renewed policy, if the claim is asserted, based upon an incorrect answer to the application question. If the potential claim is identified in answer to the application question, and no circumstance notice is given under the current policy, then the insured likely will have no coverage for that claim under the renewed policy because the insurer will exclude it, based on the answer to the application question. Accordingly, an LPL insurer that does not require the reporting of potential claims, either expressly as a part of the policy’s notice provisions or indirectly through the use of renewal applications, is much preferred from the insured’s standpoint.

E. Notice and Reporting Requirements

The assertion of a claim within the policy period may be the only event required to trigger coverage under the policy’s grant of coverage or insuring agreement. For example, the insuring agreement might state:

We agree to indemnify the Insured for Loss which the Insured becomes legally liable to pay as Damages for Claims first made during the Policy Period arising out of any act, error, or omission in rendering or failing to render Legal Services to others.

Under this language, the only temporal requirement is that the claim be “first made during the Policy Period.” Notably, under such forms, the requirement of notice to the insurer is not a part of the insuring agreement, but would appear in the policy conditions.

The policy conditions typically would require notice of the making of a claim “as soon as practicable” or “promptly” or “immediately” upon learning of a claim. Similar terminology is common in policies covering injury or damage on an “occurrence” basis. In this context, Texas courts have consistently interpreted such notice requirements to require that notice be given within a reasonable time in light of the circumstances involved.15 What constitutes a reasonable time depends on the facts and circumstances in each particular case.16 In assessing whether notice is reasonable, courts often focus on whether the delay in giving notice was unexcused or excused. Significantly, under these notice provisions, even if an insured fails to provide notice within a reasonable period, the insurer must demonstrate it suffered prejudiced from such delay in order to sustain a denial of coverage.17

In addition to requiring that a claim be first made during the policy period, LPL policies often impose a second requirement to trigger coverage — mandatory reporting to the insurer of the claim either during the policy period or within a short grace period after the policy expires. In this type of policy, the reporting requirement is made a part of the insurance agreement, and actually defines the scope of coverage provided by the policy. A claims-made-and-reported policy will explicitly state the reporting requirement and will often contain cautionary language at the top of the first page of the policy. The TLIE policy, for example, states at the top of page 1:

This is a “claims made and reported” policy. Subject to the terms, conditions, exclusions and limits of liability, the policy provides coverage only for Claims that are first made against the Insured and reported in writing to the Association during the policy period, regardless of when the acts, errors or omissions on which the Claim is based occurred.

(emphasis in original).

Under claims-made-and-reported policies of this type, the transmittal of notice of the claim or occurrence to the insurer is the event that triggers

---


16 E.g. Matthew v. Home Ins. Co., 916 S.W.2d 666, 669 (Tex. App.—Houston [1st Dist] 1996, writ denied) (notifying insurance company of a claim more than six months after being served with a lawsuit was not “as soon as practicable” or “immediately”).

17 See PAJ, Inc. v. Hanover Ins. Co., 243 S.W.3d 630, 636 (Tex. 2008) (holding insured’s failure to timely notify insurer under an occurrence policy does not defeat coverage if insurer was not prejudiced by delay).
coverage. A requirement that a claim or occurrence be reported to the insurer during the policy period, or within a specific number of days thereafter, defines the scope of coverage by providing a certain date after which an insurer knows it is no longer liable under the policy.\(^{18}\) Thus, in contrast to policies merely requiring notice, the reporting requirement of a claims-made-and-reported policy is strictly enforced without any required showing of prejudice.\(^{20}\)

**F. Circumstance Notice**

A claim is deemed to have been made when the insurer either receives written notice from the insured that a claim has been made or when the insurer receives written notice from the insured of specific circumstances that may result in a claim. The latter scenario is referred to as “circumstance notice.” The case law pertaining to circumstance notice provisions has principally arisen in the context of D&O insurance.

As one court correctly noted, “notice of circumstances” provides “a mechanism for extending coverage beyond the policy period where ‘facts and circumstances’ that might give rise to a claim are known, but no ‘claim’ has been asserted against the insured.”\(^{20}\) In other words, once a valid “notice of circumstances” has been given, and if the potential claim is subsequently asserted against the insured, it will then be treated as if it were first made during the policy period — even if the claim is in fact made after the policy has expired. If no circumstance notice were permitted, the insured would find itself at the mercy of the claimant’s timing.

In the LPL context, the wording of circumstance-notice provisions varies materially. All of them, however, require some degree of specificity, detailing the “circumstances” in question. Circumstance notices that are overbroad, mere “laundry lists” providing a “kitchen sink” of hypothetical possibilities are typically ineffective. As one court noted in holding an insured’s notice ineffective:

> [The insured’s] letter did no more than recite the language of the policy’s notice provision and identify the FDIC as the source of potential claims. . . . Failure to describe the

basis of a claim in greater detail precludes coverage under the policy. The insured simply may not, through rote incantation of the policy terms, gain coverage under a claims-made policy for undiscovered, wrongful acts that in some sense “occurred” during the policy term.\(^{21}\)

The Fifth Circuit has followed this principle, explaining that “the proper focus of the district court’s inquiry is whether the insured has objectively complied with the policy’s notice provisions, and not whether the insurer could subjectively draw inferences as to the potential claim.”\(^{22}\)

The insured, naturally, would prefer a circumstance-notice provision that is simple and user friendly, along the lines of the following:

> A Claim shall be deemed as being first made at the earlier of the following times:

   A. [when notice is received of a claim]; or

   B. When the Company first receives written notice from the Insured or its representatives of specific circumstances involving a particular person or entity which may result in a claim.

The brevity of this clause differs from the more detailed provision at issue in *National Union Fire Ins. Co. v. Willis*, 296 F.3d 336 (5th Cir. 2002):

> If during the Policy Period or during the Discovery Period (if applicable) the Company or the Insureds shall become aware


\(^{22}\) *Federal Deposit Ins. Corp. v. Mijalis*, 15 F.3d 1314, 1335 (5th Cir. 1994); *see also Resolution Trust Corp. v. Ayo*, 31 F.3d 285, 291 (5th Cir. 1994) (dismissing the subjective knowledge of the insurer as irrelevant and requiring proper notice be a showing of “specified wrongful acts, errors, or omissions that may give rise to a claim”). Compare *McCullough v. Fidelity and Deposit Co.* (notice not sufficient); *FDIC v. Booth*, 82 F.3d 670 (5th Cir. 1996) (notice not sufficient) with *FDIC v. Interdonato*, 988 F. Supp. 1, 3-4 (D.D.C. 1997), *aff’d per curiam* 172 F.3d 919 (D.C. Cir. 1998) (notice sufficient); *Continental Ins. Co. v. Superior Court*, 43 Cal. Rptr. 2d 374 (Cal. Ct. App. 1995) (notice sufficient); *American Cas. Co. v. Sentry Fed. Sav. Bank*, 867 F. Supp. 50, 60 (D. Mass. 1994) (holding that a notice of circumstances was sufficient because it simply, but adequately, described the potential plaintiffs, defendants, and circumstances).
of any circumstances which may reasonably be expected to give rise to a Claim being made against the Insureds and shall give written notice to the Insurer of the circumstances and the reasons for anticipating such a Claim with full particulars as to dates, persons, and entities invoked, then any Claim which is subsequently made against the Insureds and reported to the Insurer alleging, arising out of, based upon or attributable to such circumstances or alleging any Wrongful Act which is the same as or related to any Wrongful Act alleged or contained in such circumstances, shall be considered made at the time such notice of such circumstances was given.

Id. at 339–40 (emphasis added). Whether this provision imposes a mandatory notice requirement is subject to some doubt. Both the “if/then” structure of the clause and general recognition that circumstance-notice provisions are not typically intended to be mandatory, suggest that the provision provides an option the insured. Nonetheless, the court in Willis accepted National Union’s argument that coverage was foreclosed by the insured director’s failure to give notice of a circumstance during the policy period.

Chartis, formerly AIG, the parent of National Union, continues to use essentially the same circumstance notice provision.24 Indeed, the current Chartis provision not only includes the elements of the National Union provision quoted above, but also requires the insured to give notice of the “Wrongful Acts allegations anticipated.” Thus, this LPL insurer apparently requires the following: (a) during the policy, notice of circumstances is provided that, (b) tested objectively using a “reasonable person” standard, may give rise to a claim, (c) an explanation of reasons for anticipating the claim, (d) identification of the claimed breaches of duty anticipated (“Wrongful Acts”), as well as (e) “full particular as to dates, persons, and entities.”

As a practical matter, the decision-making sequence when analyzing notice of a potential but unasserted claim under a LPL policy should take the following questions into account: First, what is textually required by the relevant policy’s circumstance-notice provision? Next, does the text of the notice provision pose a risk that it might be read as requiring mandatory notice? Third, does the insured have sufficient specific information to give a compliant notice to the insurer? Fourth, what assessment is to be made of the relative risk of a challenge to an arguably non-specific notice versus the risk of an argument that notice should have been given in a prior year? The former includes the risk that the renewal policy will not cover a claim arising from the circumstance because it is excluded, either specifically or by exclusions applicable to anticipated claims or claims arising from matters noticed to insurers in prior years. Lastly, some assessment should be made of the potential disadvantages to giving notice of circumstances that might be discovered by the claimant.

G. Coverage of Defense Expense

LPL policies are written either on a “pay on behalf of” or indemnity basis. “Pay on behalf of” policies, require the insurer to pay defense expense and settlements or judgments initially, without any expectation of funding by the insured. “Indemnity” policies, by contrast, require the insured to pay first, and then to seek reimbursement from the insurer. Where coverage issues or other disputes arise between insurer and insured, the timing of reimbursement may be a crucial issue.

LPL policies for solo practitioners and small and midsize firms are typically written on a “pay on behalf of” basis. LPL policies for large firms are typically written on an “indemnity” basis. “Pay on behalf of” policies, including LPL policies, typically impose a “duty to defend” on the insurer. Under indemnity forms, the insured is obliged to manage its own defense and seek reimbursement of defense costs. In either case, under LPL policies, defense expense is typically covered “within the limit” of liability, meaning that the limit of liability available to pay a settlement or judgment is reduced or “eroded” by payment of defense expenses.

In general, “pay on behalf of” policies providing a duty to defend are more protective of the insured than policies written on an indemnity basis. Duty to defend forms reduce the risk of out-of-pocket payments by the insured, other than the insured’s obligation to pay its deductible. They give the insured the benefit of the insurer’s Stowers duty to exercise reasonable care in making settlement decisions, which insurers may argue exists only where the insurer exercises the degree of control over the defense that is typical under a duty to

23William E. Knepper & Dan A. Bailey, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS § 24.08 (7th ed. 2003) (“D&O policies allow (but do not require) the insured to give notice of that potential Claim to the insurer during the policy period”).


25Id.
defend policy. For firms purchasing modest limits of liability in comparison with their LPL exposures, this consideration may be key.

Indemnity policies oblige the insured to conduct its own defense, although the extent of the insurer’s prerogatives is typically limited by provisions requiring the insurer’s consent to the defense expense incurred and provisions limiting the insured’s choice of defense counsel. Thus, under LPL indemnity forms, the specific wording addressing the extent of the insurer’s control is material, as are provisions addressing the timing of reimbursement of defense expense. Preferred LPL indemnity policies require the payment or reimbursement of defense expense within some identified time frame.

Disputes under indemnity LPL forms as to the amount of reimbursable expense include issues as to reasonableness and the insurer’s right of consent, and apportionment or allocation of some part of defense expense incurred defending non-covered claims. Much of the pertinent case law addressing these issues arises in the context of other errors and omissions coverage, particularly D&O insurance.

Texas law supports the conclusion that a duty to advance or reimburse defense costs and expenses poses issues analogous to the duty to defend and should, therefore, be governed by the same principles. In Pendergest-Holt, for example, the court found that the familiar “complaint allegation” or “eight corners” rule applied to disputes regarding the insurer’s contractual obligation to advance and reimburse defense costs and expenses, even in the absence of a contractual duty to defend. According to the court, if a contemporaneous duty to advance or reimburse defense costs were judged on an “actual facts” basis, an insurer’s contractual obligation to pay defense costs could change on a daily basis as additional “facts” developed, allowing the insurers to suspend defense expense coverage at its discretion. This view is consistent with that expressed by other courts.

Out-of-state authorities on this point include: Great Am. Ins. Co. v. Geostar Corp., Nos. 09-12488-BC, 09-12608-BC, 09-14306-BC, 2010 WL 845953, at *17 (E.D. Mich. Mar. 5, 2010) (stating that a duty to advance defense costs should be analyzed using the eight-corners rule, even when the policy disclaims duty to defend); Julio & Sons, 591 F. Supp. 2d at 659 (New York court applying Texas law, holding that reasons for eight corner rule applied to the duty to advance defense expense); Willis, 139 F. Supp. 2d at 833-35 (applying the eight-corners rule to determine whether the alleged causes of action were “potentially” covered, thus, requiring the insured to give notice and triggering the insurer’s obligations to advance defense costs and indemnity).

26G.A. Stowers Furniture Co. v. American Indem. Co., 15 S.W.2d 544, 547 (Tex. Comm’n. App. 1929, holding approved) (reasoning that a duty to exercise ordinary care in settlement decision making arose under a duty to defend auto policy from the insurer’s exclusive control over the defense of the suit); Int’l v. Nat’l Union Fire Rocror Ins. Co., 77 S.W.3d 253 (Tex. 2002) (action to recover defense expense allegedly incurred as a result of insurer’s failure to promptly settle; imposing Stowers-type duty under an indemnity policy because insurer assumed exclusive control over settlement negotiations).


29681 F. Supp. 2d at 826-29. On appeal, the Fifth Circuit discussed the issue whether the eight-corners rule should apply in a case involving the duty to advance defense costs. Pendergest-Holt v. Certain Underwriters at Lloyd’s of London, 600 F.3d 562, 574 (5th Cir. 2010). The court determined, however, that it did not have to resolve the issue because under the plain terms of the D&O policy in question, the contract specifically contemplated the use of extrinsic evidence in making the determination whether to advance defense costs. Id.

IV. THE INSURING AGREEMENT, POLICY EXCLUSIONS, AND OTHER COVERAGE LIMITATIONS

The policy’s insuring agreement states the extent of the grant of coverage; exclusions state exceptions to the coverage granted. Limitations on the scope of coverage often are stated in definitions of key terms used in the insuring agreement. Endorsements modify the standard form, called the “coverage part.” The following discussion summarizes the principal coverage issues posed by the insuring agreement and exclusions in LPL policies.

A. What Conduct is Covered?

In general, policy forms available to large law firms contain broad insuring agreements, partly as a result of the breadth of services that large firms provide. The scope of insuring agreements in LPL policies available to solo practitioners and small firms is typically narrower. This difference may or may not be material, depending on the nature of the insured lawyer’s practice.

All LPL policies cover the insured’s liability for errors or omissions in rendering legal services to others. Wording differences in the insuring agreement and defined terms — such as the definition of “professional services” and other insuring agreement terminology — vary the scope of the coverage granted, often in nuanced ways.

Lawyers may provide services that are (strictly speaking) arguably not legal services, arguably not professional in nature, or both. Insureds would thus prefer coverage arising out of errors and omissions in the ordinary course of practicing law, whether or not those activities are literally the rendition of legal services, and whether or not they are categorized as “professional” in nature. Regarding the “legal services” issue, LPL insuring agreements covering services provided in the practice of law afford somewhat broader coverage than policies providing coverage only in the insured’s capacity as a lawyer, arguably implying that conduct in other capacities is not covered.

The professional-services issue also poses a threat to coverage because insuring-agreement wording limiting coverage to services that are both “professional” and “legal” are more confining than insuring agreements in which insured “professional services” are “legal services.” The first part of the TLIE insuring agreement illustrates the latter:

1.15 "Professional Services" means:

(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, escrow agent or in any similar fiduciary capacity; 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, and
(d) legal services performed for others as a Lawyer in researching or certifying title to real estate and in closing real estate transactions as an escrow officer on behalf of a title insurance company, unless otherwise excluded.

By comparison, a more confining grant of coverage than that provided by the (a) component of the TLIE definition would be afforded by an LPL form defining “Legal Services” as “professional services rendered by a lawyer.” In this formulation, “professional services” are logically a subset of “legal services.”

One case illustrating the “professional services” limitation is Gregg & Valby, L.L.P. v. Great American Ins. Co., 316 F. Supp.2d 505 (S.D. Tex. 2004) (Lake, J.), in which a law firm’s billing and fee-setting practices were held to be administrative tasks “inherent in the ordinary course of practicing law.” The firm was held liable for its actions even though it performed services that were arguably not legal services, professionally or otherwise.

Alternatively, some out-of-state authorities in the D&O context suggest that, in cases involving covered and non-covered claims, the insured may recover all defense expense reasonably related to the defense of covered claims. See, e.g., Safeway Stores, Inc. v. Nat’l Union Fire Ins. Co., 64 F.3d 1282, 1289 (9th Cir. 1995) (citing Raychem Corp. v. Federal Ins. Co., 853 F.Supp. 1170, 1182 (N.D.Cal. 1994)).

For more information about coverage options, see http://www.americanbar.org/content/dam/aba/migrated/legal services/lpl/downloads/checklist.authcheckdam.pdf. For a helpful checklist of key issues to consider in purchasing insurance, see http://www.americanbar.org/content/dam/aba/migrated/legal services/lpl/downloads/checklist.authcheckdam.pdf.
to all businesses,” not requiring “specialized legal skill and knowledge,” and thus not constituting professional services for purposes of LPL coverage. The result in Gregg & Valby was based on the holding in Atlantic Lloyd’s Insurance Co. of Texas v. Susman Godfrey, L.L.P., 982 S.W.2d 472, 476-77 (Tex. App.—Dallas 1998, pet. denied), in which the court refused to enforce a professional liability exclusion to a defamation claim otherwise covered under the “personal injury” coverage of a general liability policy. Specifically, the court held that that solicitation of clients does not require the specialized skills particular to the legal profession and was not an excluded activity, stating the view:

To qualify as a professional service, the task must arise out of acts particular to the individual’s specialized vocation. We do not deem an act a professional service merely because it is performed by a professional. Rather, it must be necessary for the professional to use his specialized knowledge or training.

Obviously, the confines of this definition, which limited the scope of the professional services exclusion, would have the effect of limiting the scope of coverage where professional services is included as an insuring agreement criterion.

Where non-professional or non-legal service is expressly excluded, coverage may be precluded entirely, even if the claim includes a component comprising professional legal services. This is so because exclusions often are worded to render the policy inapplicable to any claim “arising out of” the excluded subject. As a result, broadly worded “arising out of” exclusions are threatening from the insured’s standpoint. Common exclusions, limiting the scope of coverage for professional legal services, include, for example, exclusions of liability as the result of:

- Service as a director, officer, or employee of for-profit entities that are not named as insureds under the policy, and charitable entities, including corporations, partnerships, or trusts;
- Service as a public official; and,
- Service as a broker, realtor, dealer, investment or financial advisor, or accountant.

Some LPL insurers offer various supplemental coverages, either as a part of their standard form, or by endorsement for additional premium, often subject to a “sublimit” of liability. Of these, the most important is probably coverage for “personal injury” offenses (false arrest and imprisonment, malicious prosecution, defamation), which overlap similar coverages provided under the “personal” and “advertising” injury coverage provided by general-liability policies. This coverage is important where a lawyer’s or firm’s general-liability policy contains a professional-services exclusion. Other supplemental coverages include expenses associated with disciplinary proceedings.

Other issues posed by typical LPL insuring agreements include:

- The extent to which the policy covers services that are partly in the service of the insured firm, but that partly are not. Coverage limitations in this respect may be imposed by policy wording limiting covered services to those “solely” on behalf of the insured firm, as well as exclusions of moonlighting or “off the books” legal practice.
- Legal services while acting in the capacity of an administrator, conservator, receiver, executor, guardian, or trustee are typically covered, although the extent of this coverage varies from policy to policy. Business activities undertaken in a fiduciary capacity are generally not covered by LPL policies, a limitation implemented in some forms by excluding fiduciary services that are not typically provided by attorneys.
- Similarly, real estate-related services, including acting as a title agent and issuing title opinions are often covered, although the extent of this coverage varies and may be subject to material limitations.
- Ancillary services that are typically covered by LPL policies include acting as a mediator, service

---

33 See also National Union Fire Ins. Co. of Pittsburgh, PA v. F.D.I.C., No. 3-90-0492-H, 1991 WL 716787, at *6 (N.D. Tex. 1991), in which the court held that an attorney’s failure to monitor and discover conflicts of interest amounts to “professional services” because specialized knowledge is required for putting in place systems to ensure that professional ethical standards are met. However, the court’s definition of professional services was apparently more confusing that that stated in Atlantic Lloyds: “[T]he term ‘professional services’ applies to activities: (1) that require specialized knowledge and skills; and (2) for which the members of a profession are held to a standard different from that to which people are held in other affairs.”

34 See, e.g., Willbros RPL, Inc. v. Continental Cas. Co., 601 F.3d 306 (5th Cir. 2010) (citing cases addressing the meaning of “arising out of”).

---

35 See The Home Ins. Co. of Indiana v. Walsh, 854 F. Supp. 458 (S.D. Tex. 1994) (excluding from coverage malpractice claim based upon work performed by attorneys in their capacities as owners of savings and loan association).
on bar committees, and the provision of notary public services.

- Lobbying may or may not be covered.
- Speaking and writing on the law is usually covered, but often only if remuneration for doing so does not exceed a stated amount.
- Substantive practice specialties that may not be covered under some LPL policies include intellectual property and securities law, and state and municipal finance.
- LPL policies typically apply only to claims made or suits brought within United States, although worldwide coverage is available.

B. Whose Conduct is Covered?

LPL policies typically cover the firm and its former and current lawyers as insureds, including newly arriving lawyers, and provide coverage either for non-lawyer employees or coverage for vicarious liability for employees’ errors or omissions. Coverage for predecessor firms and contract lawyers or “independent contractors” is common.

As a result of coverage for former lawyers, departed lawyers, whether they retired or moved to other firms, are typically covered by their former firm’s on-going LPL coverage. By contrast, new hires are typically covered only for conduct after the date of hire. As a result, most LPL policies do not cover incoming lateral hires for their “prior acts” while practicing at their former firms.

LPL coverage is invariably limited to conduct while acting on behalf of the firm (or named insured). Occasionally, this limitation is expressed using different wording such as language requiring that the lawyer’s work be within the course or scope of the firm’s practice. These limitations pose coverage risk for “off the books” or “moonlighting” practice.

C. Exclusions and other Coverage Limitations

Policy exclusions are listed in the section of the policy bearing that title; other coverage limitations are stated in the definitions of terms used in the insuring agreement, particularly the definition of covered “loss” or “damages,” which is used to list elements of recovery that are not covered. Damages elements typically defined as outside the category of covered loss include civil and criminal fines and penalties, the return or restitution of legal fees, and expenses associated with equitable relief. LPL forms typically do not expressly exclude punitive damages, although a number of forms state that they do not cover multiplied damages or damages not insurable as a matter of public policy.

As a practical matter, some exclusions are redundant of limitations otherwise imposed by the insuring agreement, such as those addressing “prior acts” limitations and conduct not in the capacity of a lawyer. As suggested above, exclusions probably pose a greater coverage threat than insuring-agreement limitations because they typically reach all liability “arising out of” the excluded item. The same substantive issue, if addressed in the insuring agreement, may at least leave open the possibility of coverage for some other, covered aspect of the claim.

The so-called “conduct” exclusions eliminate coverage for criminal or fraudulent conduct; often exclude malicious or dishonest conduct; and exclude conduct by which the insured gains profit or advantage to which the insured was not legally entitled. These exclusions pose three issues. The first is the exact wording of the exclusion. For example, exclusions applying to the conduct of “an” or “any” insured, as opposed to exclusions concerning acts of “the” insured, operate to bar coverage for all insureds when one insured commits a proscribed act. Similarly, an exclusion of “actual fraud” presumably would not include constructive fraud.

37The Texas Supreme Court’s most recent opinion on this issue is *Fairfield Ins. Co. v. Stephens Martin Paving, L.P.*, 246 S.W.2d 653 (Tex. 2008) (holding that Texas public policy does not prohibit coverage for punitive damages under Coverage B of a standard workers’ compensation and employer’s liability policy).

38 The impact of fraud exclusions in LPL policies may be somewhat limited by the rule that a client suing for legal malpractice may not recharacterize or “fracture” his claim for legal professional negligence by asserting other causes of action. See, e.g., *Sledge v. Alsup*, 759 S.W.2d 1 (Tex. App. – El Paso 1988, no writ); *Aiken v. Hancock*, 115 S.W.3d 26 (Tex. App. – San Antonio 2003, pet denied); but see *Sullivan v. Bickel & Brewer*, 943 S.W.2d 477 (Tex. App. – Dallas 2005, writ denied) (allowing fraud claim).

39 *Coregis Co. v. Lyford*, 21 F. Supp.2d 695, 698 (S.D. Tex. 1998) (holding that policy exclusion for prior acts applied not only to the individual lawyer who had failed to disclose a potential claim, but also to the entire law firm); see also *TIG Specialty Ins. Co. v. Pinkmonkey.com Inc.*, 375 F.3d 365 (5th Cir. 2004) (distinguishing between personal profit exclusion applicable to “any insured” and exclusion applying to “the” insured in D&O policy, holding that exclusion defeated coverage for all insureds).

40“Actual fraud usually involves dishonesty of purpose or intent to deceive, whereas constructive fraud is the breach of some legal or equitable duty which, irrespective of moral guilt, the law declares fraudulent because of its tendency to...
A second conduct-exclusion issue is that of “severability” or non-imputation of the conduct of one insured to another. This is the question of whether coverage for an “innocent” insured will be foreclosed by the conduct of a “bad” insured. Most LPL policies contain some version of a “severability” provision in favor of “innocent” insureds, although most exclude coverage for the firm based on the conduct of a partner.

The third issue is the extent to which the conduct exclusions impact coverage, including payment of defense expense, where the excluded conduct is merely alleged and has not been found as a fact, or, if found, is subject to an appeal. Unlike D&O policies, which exclude fraud only if found “in fact” or by a “final adjudication,” some LPL forms exclude conduct “allegedly” within the “conduct” exclusions. Under LPL policies providing a duty to defend, these broadly drawn exclusions should not defeat the duty to defend where the pleading also asserts a claim for negligence. Under indemnity policies, however, conduct exclusions that do not contain “in fact” or “final adjudication” conditions to the applicability of the exclusion may limit the insurer’s obligation to reimburse defense expense.

LPL policies typically do not exclude liability under the Texas Deceptive Trade Practices Act. The DTPA expressly exempts a “claim for damages based on the rendering of a professional service, the essence of which is the providing of advice, judgment, opinion, or similar professional skill.” TEX. BUS. & COMM. CODE § 17.49(c). This exemption, however, does not apply to express misrepresentations, unconscionable actions, or breaches of warranty “that cannot be characterized as advice, judgment, or opinion.” The excepted DTPA causes of action are occasionally asserted as a part of legal malpractice claims. E.g., Latham v. Castillo, 972 S.W.2d 66 (Tex. 1998) (allowing DTPA unconscionability claim, prior to §17.49(c) amendment, based on misrepresentation that suit had been filed). The scope of LPL coverage for DTPA claims within the exceptions is problematic due to the LPL insuring agreement limitations and “conduct” exclusions discussed above.

LPL policies typically exclude claims made by one insured under the policy against another insured, although many broadly except legal malpractice claims arising from an attorney-client relationship among firm personnel. LPL policies also often exclude claims by business enterprises in which an insured owns an interest or exercises managerial control.

LPL policies typically exclude liabilities that are intended to be covered under other types of insurance policies. Thus, they exclude liability for bodily injury or property damage, inasmuch as liability for these damages is covered by general liability and auto insurance policies. They frequently exclude discrimination, and employment related misconduct, as liability for these damages are covered by employment-practices insurance policies. They also exclude claims made against ERISA fiduciaries, as these claims are often covered by endorsements of fiduciary coverage — typically to general-liability policies.

LPL policies also frequently include a related-claims clause, which is sometimes labeled an exclusion in the policy and sometimes labeled a condition. These related-claims provisions generally state that any claim (as defined in the policy) that is related to or arises out of the same facts or transactions as another claim or claims, will be considered a single claim. When the “claims being compared all arise within the same policy period, the frequent effect of the provision is to limit the deductibles and limits of liability applicable to these related or consolidated claims. When related claims span policy periods, however, then the provision can operate to exclude the later claim because it relates back to a claim that was made within another policy period. The language in these related-claims provisions can vary from narrow to broad, and the case law is inconsistent, at best, as to how much of a “relationship” is necessary to be considered one claim.

Coverage issues posed by policy conditions that are generic to all liability policies, such as the insured’s duty to cooperate, are outside the scope of this paper. One common LPL condition, however, is a provision requiring the insured’s consent to settlements proposed by the insurer. These provisions are included based on the assumption of potential reputational damage as a result of a settlement. Where the insured’s consent is required, however, LPL policies contain a so-called “hammer clause,” limiting the insurer’s liability under the policy to the amount of the settlement recommended by the insurer but refused by the insured.

---

41 This is so under the rule that an insurer’s duty to defend, if triggered by a covered allegation, extends to the whole case. E.g., Nat’l Union Fire Ins. Co. v. Merchants Fast Motor Lines, Inc., 939 S.W.2d 138, 141 (Tex. 1997); Willbros RPL, Inc. v. Continental Cas. Co., 601 F.3d 306, 310 (5th Cir. 2010).
BIBLIOGRAPHY


“Selecting Legal Malpractice Insurance 2007,” ABA Standing Committee on Lawyers’ Professional Liability. This source is largely duplicated at the ABA’s website, [http://www.americanbar.org/groups/lawyers_professional_liability.html](http://www.americanbar.org/groups/lawyers_professional_liability.html).