Preparing for the Worst: Considerations in Purchasing Legal Malpractice Insurance—Part I

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Do I really need lawyers professional liability insurance?

In short—yes! Lawyers professional liability (also known as LPL) insurance is the more formal name for legal malpractice insurance. Although there is no specific requirement under the Rules of Professional Conduct for attorneys in Pennsylvania to carry LPL insurance, Rule 1.4(c) (part of the requirement for "communication") requires lawyers in private practice to notify new clients in writing if they do not have professional liability insurance of at least $100,000 per incident and $300,000 total per year. The insurance must be subject to "commercially reasonable deductibles, retention or co-insurance." Lawyers must also inform clients if they become uninsured at these levels at any point. Comment 8 exempts from this rule attorneys who do not have private clients, including attorneys in full-time government practice or employed full-time as in-house corporate counsel.

The American Bar Association has variously reported that in any given year, an attorney has a 4 to 17% chance of being sued and that four out of five attorneys will face a lawsuit in their careers. The cost of defending a legal malpractice claim can very greatly depending on the complexity of the matter, but the average defense cost generally will exceed $50,000, and can easily exceed $100,000. Many more complex cases have defense costs that exceed $500,000.

Even if you are impeccable in your own practice, claims can arise due to errors or wrongdoing by partners, associates or staff. A significant number of legal malpractice cases are completely meritless, which means that they could not have been prevented. Most LPL carriers also have loss-prevention services including low-cost or free CLEs and potential claim repair assistance. LPL insurance may also provide coverage if you are served with a subpoena to either produce documents or to give a deposition, both of which can involve difficult questions of client confidentiality requirements under the Rules of Professional Conduct. Some LPL insurance policies also provide coverage for representation before the Disciplinary Board due to alleged ethical violations and/or some limited coverage for cyber events.

First consideration: How much insurance do I need?

There is no right answer to this question. The answer will depend to some degree on the value of cases you are involved in and your appetite for risk. As a general rule, legal malpractice actions are valued by the "case-within-the-case." That is, a claim for legal malpractice is worth as much as the value of the underlying claim that was lost due to the attorney's misconduct. Therefore, if the statute of limitations is blown on an underlying personal injury claim, the plaintiff can recover against the attorney for the value of the underlying personal injury claim. Legal malpractice claims involving real estate transactions can easily run into the millions of dollars depending on the size of the transactions. Wills and estates and family law matters can very greatly in size depending on the wealth of the individuals you represent. Intellectual property legal malpractice claims are notorious for the size of the claims involved.

In general, determining how much insurance you need involves calculating how much is at risk if your best cases go bad. In most areas of practice, the answer is that there is a significant risk of claims that could have a value in excess of $1 million. While the cost of insurance may make it tempting to maintain a minimal amount of insurance, the protection provided by $100,000/$300,000 policy is very limited.

Second consideration: Eroding limits?

Most insurance companies offer LPL policies with eroding limits, also know as defense costs inside limits, or more brutally, a "burn down" policy. In these policies, the costs of defense "erode" the limits of the policy. Therefore, if you have a policy that provides limits of $300,000 per claim, and the defense cost on the claim is $75,000, only $225,000 remains to pay a potential judgment. Eroding limits policies are attractive because they are cheaper than policies with claim expenses outside the limits (CEOL) policies. However, eroding limits policies can easily put you in a situation where defense costs exhaust the policy leaving you to pay for settlement of a judgment out of pocket.

Most LPL policies have a consent to settle clause meaning the claims cannot be settled unless the insured consents to the settlement. Many companies do not offer CEOL policies because they can make the defense of a legal malpractice claim very expensive when combined with a consent to settle clause. Before purchasing an eroding limits policy, make certain that you are purchasing a policy with sufficient coverage so that the costs of defense do not leave you without funds for settlement or a judgment.

Third consideration: Will my insurance company be there when I need it?

There are currently just under 40 different companies that the ABA recognizes as writing LPL policies for firms with one to 30 attorneys in Pennsylvania. The majority of these are "admitted carriers," meaning the company has met the minimum requirements under the applicable statutes and is authorized to write LPL policies in Pennsylvania. This provides access to the guaranty fund if a problem arises with the carrier.

Insurance companies routinely enter and exit the market, and when looking at policies, it is important to consider whether your company will still be operating in Pennsylvania when you need it. It is also worth considering the experience the company has in the market. If the company has significant experience in Pennsylvania it will know the players in the legal malpractice community, both on the plaintiff's side and the defense side, and may have better insights into true value (if any) of the case against you. It can be helpful to ask questions about how long the company has been serving the market and how many attorneys it insures in Pennsylvania. A relationship with your county or state bar association can also be a good indicator of knowledge and stability.

Fourth consideration: "Claims made" and "extended reporting period."

Most, if not all, LPL policies are "claims made," as opposed to "occurrence" policies. Claims made policies are generally triggered by an actual claim made or the insured providing notice of a circumstance that could lead to the existence of a claim in the future. Different policies can have quite different definitions of what constitutes a claim and whether the insured is required to report potential claims. Generally, a claim is defined as a specific demand for relief, often as a written demand for monetary release.

Since claims made policies generally expire entirely at the end of the policy period, an attorney changing insurance carriers must determine the extent to which the policy covers "prior acts." "Prior acts" are actionable conduct that occurred before a certain date, generally, the effective date of the first LPL policy purchased from the carrier. When purchasing coverage from a new carrier, you must determine what the retroactive/retrospective date for prior acts is under the policy. That is, if you made an error two years prior to purchasing the policy, but the claim is not made until after the new policy was purchased, will the policy cover the prior acts.

In the next article we will review some considerations regarding what a policy covers and does not cover. We will also look at important exclusions and considerations for other coverages.

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