What to Look for When Purchasing Professional Liability Insurance

by Jerriann Weiser and Gary A. Friedman

Lawyers are being sued in unprecedented numbers by their clients. Legal malpractice claims tripled during the 1980s, and this number is expected to climb by 155 percent in the 1990s. Colorado appears to be mirroring the national trend, with claims rising both in severity and frequency. There are a number of reasons that can explain this increase, two of which are: (1) increasing complexity of the law and greater specialization in the legal field, adding to the possibility of error, and (2) attorneys seem to be less reluctant to make legal malpractice claims against each other than in the past.

As a result of this tremendous rise in litigation against attorneys, it is more important than ever that attorneys carefully select both the broker and the insurance company when purchasing legal professional liability insurance. While price is always a consideration, this article focuses primarily on the issues in selecting the broker, the insurance company and the insurance coverage.

Selecting the Broker

The primary responsibilities of the insurance broker are to place the insurance coverage with a reputable insurance company, explain the coverages provided by the policy and assist with filling out the insurance applications. However, the firm should be responsible for completing the application because it is possible that the application may be made a warranty to the actual insurance policy.

When selecting an insurance broker, a firm or sole practitioner should select one that specializes in lawyer's professional liability insurance. Professional liability has become increasingly complex area of commercial insurance. Specialization in this area of insurance shows that the broker is dedicated, knowledgeable and experienced.

Selecting the Insurance Company

The choice of insurance companies has increased considerably over the past few years. With this greater selection also comes a broader variation from one policy to the next. When selecting the insurance company, the decision can be made by first making a judgment about the insurance company and the services it provides, and then analyzing the actual insurance policy.

Admitted Versus Nonadmitted

When selecting an insurer, the attorney should find out if the company is “admitted” in the state of Colorado. An admitted company is one in which the insurance commissioner has analyzed the financial security of the company in light of the minimum requirements established by state statute. Once an insurance company is admitted, it is monitored each year. A nonadmitted company is not licensed by the state's division of insurance, but operates within the state surplus lines insurance laws.

A state's guaranty fund laws generally apply only to admitted carriers (guaranty fund laws provide some measure of financial compensation to insureds if an insurance company becomes insolvent). An insurance company may choose to be admitted or nonadmitted in any given state. If a company chooses to be a nonadmitted company, it does not mean it is not reputable. A company may be operating on a nonadmitted basis to avoid state rate and policy requirements, thus allowing for greater flexibility in coverage and rates.

The Directory of Lawyer’s Professional Liability Insurance Companies provides a listing of available insurance companies in Colorado.

Financial Rating

The financial strength of the insurance company is a very important consideration. There are a number of sources available that provide information about an individual insurance company's financial position. Two standard sources are Best's Key Rating Guide and Standard & Poor's Insurance Rating Services.

In general, these sources analyze insurance companies using a number of financial criteria (such as profitability and capitalization) and nonfinancial criteria (such as management expertise and spread of risk). They then apply a rating unit based on these factors, depicting companies that

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This column is prepared by the Colorado and Denver Bar Association Law Practice Management Committees to share ideas on more efficient and effective law practice management. This month's article was written by Jerriann Weiser, CIC, AIA, Denver, vice-president, and Gary A. Friedman, RPLU, ARM, AAI, account executive, with Van Gilder Insurance Corporation, (303) 837-8500.
are "secure" or "vulnerable." Obviously, the higher the rating given to the insurance company, the greater the insured's peace of mind in knowing that the insurer will be around to handle a claim when it occurs.

**Risk Management and Claims Service**

An additional factor that should be considered in selecting an insurance company is the claims service provided by the company. The company should be able to provide a firm or practice with claims personnel who are experienced in handling legal malpractice claims. It is also important that the insurance company work with local legal defense counsel because of their greater familiarity with the law in a given state.

Simply stated, a firm with no claims will have a lower premium than a firm with claims. Many insurance companies offer claims-free credits that can significantly lower premiums. Many companies offer on-site and large group seminars aimed at helping firms reduce the potential for claims. In addition, many companies send newsletters filled with tips on how to reduce and prevent claims. These are just a few ways an insurance company can help a firm implement solid risk management policies, controlling and preventing claims, thus keeping insurance costs at a reasonable level.

**Selecting the Policy**

The next obvious step in selecting the insurance company is to explore the key issues of the insurance policy itself. The insurance policy is a complex contract between the insurance company and the firm. Because of the complexity, this discussion will focus on some key issues to examine when analyzing a policy.

**Claims Made Coverage**

Malpractice policies for attorneys are written on a "claims made" basis, which is a term that is defined in the policy. Claims made coverage means that coverage applies to claims that are made against the firm during the policy period as long as the act or incident that gave rise to a claim occurred after the retroactive date.

The retroactive date on the claims made policy triggers the beginning period of coverage. A retroactive date is not required on all claims made policies. However, if a retroactive date does appear on the policy, a claim made during the policy period will not be covered if the act or incident occurred prior to this date.

**Prior Acts Coverage**

Coverage for prior acts becomes a significant issue when a firm is purchasing a policy for the first time or when a firm is looking to replace its current malpractice policy with a different insurance company. When purchasing a malpractice policy, a firm needs to know whether the policy will respond to claims that are made against the firm from an unknown incident that occurred prior to the new or replacement policy being issued. In order to protect a firm from these incidents, an insurance company may offer prior acts coverage.

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Known incidents must be reported to the existing insurance company prior to changing companies. A new company will not cover an incident that the firm was aware of prior to the effective date of the new policy.

Questions to ask the insurance company include: Does the policy provide coverage for claims made and reported during the policy period regardless of when the incident occurs? Does the policy provide coverage for claims made and reported during the policy period for incidents that occur during the policy period? Not only is the claim response affected by how each of the above questions is answered, but also the annual premium. If the insurance company is not providing prior acts coverage, the annual premium could be substantially less.

**Extended Reporting Periods**

Should an attorney retire, become permanently disabled or cease practice, or if the policy is nonrenewed or canceled, certain steps need to be taken with the malpractice policy. Coverage ceases when the policy expires, is canceled or nonrenewed. As a result, an attorney may need to purchase an extended reporting period endorsement or "tail" policy. This endorsement essentially provides coverage for future claims that are made and reported as a result of incidents that occurred when the policy was in force.

Under CRS § 10-4-419 of the Colorado Insurance Law, insurers must offer the insured up to sixty days after the expiration date to purchase the extended reporting period endorsement. Furthermore, Regulation 5-1-8 states that the insurer must provide coverage under this extension (unless the policy is canceled for nonpayment of premium) for a period of at least one year at a premium not to exceed 200 percent of the terminated policy premium. Many insurers offer tail policies for more than the required one-year period, such as two years, three years and unlimited. Because it is quite possible for claims to be made and reported many years after an incident occurs, it may be prudent to explore the options that extend beyond the required one-year period.

**Exclusions**

There are three general types of exclusions in legal professional liability insurance: (1) those relating to extraordinary financial risk that the company is unwilling to insure, such as securities work; (2) those relating to "moral" risks, such as fraud and criminal conduct; and (3) those excluding coverage handled by other policies, such as workers' compensation and commercial liability.

Exclusions vary from one insurer to the next, so it is important to analyze the particular exclusions in light of the type of work that is done by the firm or practice.

**Limits**

A common question is what limits the firm should buy. The potential for claims in the area or areas of law practiced by the firm need to be examined when making this determination. A study entitled "Characteristics of Legal Malpractice," cited in International Risk Management, Professional Liability Insurance, encompassed 39,927 professional liability claims against lawyers. In this study, particular areas of law were examined with respect to the number of claims in these areas. The top ten areas of law with the greatest percentage of claims in descending order are: personal injury/plaintiff, real estate, collections and bankruptcy, family law, estate and probate, corporate/business organization, criminal, personal injury/defense, business transaction/commercial law, and workers' compensation.

Additional factors in determining what limits should be selected include the num-
ber of attorneys to be covered under the policy and the firm's attitude toward risk.

Who Is Covered?

An important question relates to who is covered in your policy. The firm and its employees are insured under the policy for services they perform within the course and scope of their employment.

A potentially disastrous situation occurs when a firm hires a new attorney. Many insurers' policies provide coverage for the new attorney; however, it may be prudent to explore the possibility of excluding this individual under the firm's policy because the policy may have to respond for claims made against this individual for work performed for a previous firm when that firm's insurance policy is no longer in force or will not respond to the claim.

Conclusion

The primary consideration in purchasing legal professional liability insurance should not rest with cost alone. Even though cost is a significant factor, the firm should take the time to judge carefully the services of the insurance broker. In addition, a firm should carefully analyze the various nuances of the insurance policy in relation to the areas of practice in which the firm is involved. Finally, in today's highly competitive environment, in which many insurers are underwriting legal professional liability policies, not only should careful scrutiny be given to the financial integrity of the insurer, but the firm also should make every effort to maximize the services available to the firm.

NOTES

2. Telephone interview with John M. Palmer and William F. Campbell, Jr., of the Denver firm of White and Steele (June 5, 1996).
5. ABA Standing Committee on Lawyer's Professional Liability (Chicago, 1992).
10. The format of this article does not allow for an exhaustive investigation of all the issues to consider in purchasing professional liability. For a greater detailed analysis, consult an insurance broker or other sources of information, such as The Lawyer's Desk Guide to Legal Malpractice, supra, note 4.

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