PROFESSIONAL LIABILITY ISSUES

DIANA L. FAUST
Cooper & Scully, PC
900 Jackson Street, Suite 100
Dallas, Texas 75202
(214) 712-9500
(214) 712-9540 (Fax)
Diana.Faust@CooperScully.com

14th ANNUAL INSURANCE SYMPOSIUM
NEW AND EMERGING RIGHTS OF INSUREDS
March 30, 2007
Dallas, Texas

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Cases **Page(s)**

Statutes, Rules & Constitutions **Page(s)**

Miscellaneous **Page(s)**

I. Introduction

Nationwide, the availability of relief by a client (and sometimes, a nonclient) against an attorney has expanded over the last 60 years. With remedies expanding, professional liability insurance for attorneys has, over time, become less available and more expensive. Unlike physicians and health care providers, the Legislature has not concluded that claims against attorneys be regulated or governed by statute, and, as a result, shortages in the availability of professional liability insurance have not reached a perceived crisis level in the State.

This paper will explore the historical framework underlying the current market for professional liability insurance, will discuss some of the available remedies against attorneys, and will present considerations for evaluation of coverage by the attorney insurance consumer, in light of four current specimen policies issued by carriers in the Texas market.

II. Historical Development of Professional Liability Insurance for Attorneys

As statutory developments emerged throughout the twentieth century,[1] the need for professional liability insurance for attorneys also expanded. Policies were offered beginning in the 1940s and by the 1960s, most law firms owned insurance policies covering not only indemnity for professional error, but also providing coverage for defense costs.[2] Policy language was, many times, negotiated by various bar associations.[3] Attorneys historically hit with the largest per capita number of malpractice lawsuits were the plaintiffs' bar.[4] Through the 1970s, investment advisors and attorneys practicing in the securities area were groups against whom claims began to soar; those practicing in the real estate field also became targets, with the expansion of construction of homes and the evolving transient nature of the American population fueling the increasing numbers of real estate transactions.[5] The nature of civil and criminal issues arising in securities claims has been cited as only one example of the millions of dollars of claims dollars paid in awards and settlement, such that premiums escalated and re-insurers left the market, resulting in an insurance crisis by the mid-1980s.[6] Liability trends continued through the 1990s, firms carried less insurance and paid two to four times as much as they did years earlier for much more coverage.[7]

Early policies were written on a claims-made basis, utilizing standard forms and a policy period of one year.[8] By the 1970s, insurers began inserting exclusions into liability policies concerning fraud, criminal activity, punitive damages, ERISA claims, and bodily injury.[9] By the mid-1980s and the insurance shortage, insurers made a "virtual uniform change" to include defense costs within policy limits, and included the insurer's right to control the defense.[10] Today's policies are similar to accountants' policies, and are usually purchased from a commercial carrier and sometimes through a professional society or bar association.[11] Current policies are on a claims-made form, and generally include retroactive coverage as well as extended reporting coverage, and defense costs are charged against the limits of liability under the policies.[12]

III. Bases of Liability and Damages

[1] *See* 3 ROWLAND H. LONG, THE LAW OF LIABILITY INSURANCE, § 12C.01[1], *citing* 26 U.S.C. § 1, *et seq.* (Internal Revenue Code); 15 U.S.C. § 77, *et seq.* (Securities Act); 15 U.S.C. § 78, *et seq.* (Securities Exchange Act) (2006).

[2] *Id.* §12C.01[1].

[3] *Id.*

[4] *Id.*

[5] *Id.*

[6] *Id., citing In re National Student Marketing Litigation*, 445 F. Supp. 157 (D.C.D. 1978).

[7] *Id.*

[8] *Id.* § 12C.01[2].

[9] *Id.*

[10] *Id.*

[11] *Id.* § 12C.01[3].

[12] *Id.*

Under Texas law, various bases for actions against attorneys are available. Some include: (1) negligence or legal malpractice; (2) breach of fiduciary duty; (3) violations of state or federal statutes; (4) common law fraud; and (5) breach of contract. Both suits by clients and suits by nonclients may be permissible.[13]

A legal malpractice action in Texas is based on negligence.[14] The elements of a legal malpractice claim are: (1) a duty; (2) a breach of duty; (3) the breach proximately caused the injury; and (4) resulting damages.[15] When a legal malpractice claim arises from prior litigation, the plaintiff has the burden to prove that but for the attorney's negligence, he or she would be entitled to judgment, and to show what amount would have been recovered in the judgment.[16] This is commonly referred to as the "suit within a suit" requirement.[17] Examples of client actions for negligence can range from the failure to file court papers in a timely fashion, to failure to advise the client or furnishing negligently incorrect advice to the client, and failure to investigate and evaluate the legal and factual aspects of the case.

Breach of fiduciary duty arises out of the special relationship existing between attorney and client, and can involve failure to represent the client without conflict and failing to preserve client confidences.[18] The elements of the cause of action include: (1) plaintiff and defendant had a fiduciary relationship; (2) defendant breached its fiduciary duty to the plaintiff; (3) the defendant's breach resulted in injury to the plaintiff or benefit to the defendant.[19] Remedies include actual damages, including economic damages (out-of-pocket losses and lost profits), mental anguish damages. exemplary damages, and equitable relief, such as fee forfeiture.[20] Prejudgment and postjudgment interest are recoverable, as well as taxable costs; attorney's fees are not recoverable unless recoverable by statute or in equity.

Statutory claims involving violation of federal law can arise under both the Securities Act and the Civil Rights Act. Under state law, the Texas Deceptive Trade Practices Act provides limited means of redress based on a claim involving the rendering of professional services.[21] The claim must not involve claims based on the rendition of professional services characterized as advice, judgment, opinion, or similar professional skill.[22] This is because these areas are reserved for a negligence suit.[23] Examples of DTPA claims against an attorney include misrepresentation, failure to disclose, unconscionable action, breach of warranty, or involving the sale or illegal promotion of annuity contracts.[24] Remedies may include

---

[13] *See Likover v. Sunflower Terrace*, 696 S.W.2d 468 (Tex App.–Houston [1st Dist.] 1985, no writ).

[14] *Cosgrove v. Grimes*, 774 S.W.2d 662, 664 (Tex.1989); *Zenith Star Ins. Co. v. Wilkerson*, 150 S.W.3d 525, 530 (Tex.App.-Austin 2004, no pet.); *Hall v. Rutherford*, 911 S.W.2d 422, 424 (Tex.App.-San Antonio 1995, writ denied).

[15] *Alexander v. Turtur & Assocs., Inc.*, 146 S.W.3d 113, 117 (Tex. 2004); *Cantu v. Horany*, 195 S.W.3d 867, 873 (Tex. App.–Dallas 22006, no pet.); *Hall*, 911 S.W.2d at 424.

[16] *Cantu*, 195 S.W.3d at 873; *Hall*, 911 S.W.2d at 424.

[17] *Ballesteros v. Jones*, 985 S.W.2d 485, 489 (Tex. App.–San Antonio 1998, pet. denied).

[18] *Johnson v. Brewer & Pritchard, P.C.*, 73 S.W.3d 193 (Tex. 2002) (citing examples of fiduciary relationships); *Burrow v. Arce*, 997 S.W.2d 229 (Tex. 1999) (holding client need not prove actual damages to obtain fee forfeiture in breach of fiduciary duty claim); *Abetter Trucking Co. v. Arizpe*, 113 S.W.3d 503, 508 (Tex.App.-Houston [1st Dist.] 2003, no pet.) (stating elements of breach of fiduciary claim, including damages).

[19] *Burrow*, 997 S.W.2d at 237.

[20] *See Burrow*, 997 S.W.2d at 243; *Douglas v. Delp*, 987 S.W.2d 879, 884 (Tex. 1999); *International Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 584 (Tex. 1963). *See alsoKahn v. Seely*, 980 S.W.2d 794, 799 (Tex. App-San Antonio 1998, pet. denied).

[21] *See Latham v. Castillo*, 972 S.w.2d 66, 69 (Tex. 1998) (stating elements of claim for unconscionable conduct recovery under DTPA, including damages pursuant to section 17.50(a)(3).

[22] TEX. BUS. & COM. CODE ANN. § 17.49(c).

[23] *See James V. Mazuca & Assocs. v. Schumanni*, 82 S.W.3d 90, 94 (Tex. App.–San Antonio 2002, pet denied.).

[24] *See* TEX. BUS. & COM. CODE ANN. § 17.49(c)(1), (2), (3), (4), (5).

actual damages, mental anguish, multiplied damages, and attorney's fees.

Common law fraud is also an available cause of action, the gist of which is deception about an existing fact.[25] Examples have included overcharging by attorneys on contingency fee contracts or excessive legal fees, and knowing participation in fraudulent activities while acting for the client.[26] Remedies may include actual damages and exemplary damages.

Breach of contract claims can be brought by clients against attorneys and the focus of the claim is whether the attorney performed the contract according to its terms. An example includes disputes over legal fees.[27]

[25] *Sullivan v. Bickel & Brewer*, 943 S.W.2d 477, 481 (Tex. App.–Dallas 1995, writ denied). *See De Santis v. Wackenhut Corp.*, 793 S.W.2d 670, 688 (Tex. 1990) (stating elements of fraud claim, including injury to party claiming fraud).

[26] *See Lopez v. Munoz, Hockema & Reed*, 22 S.W.3d 857, 859 (Tex. 2000); *Jampole v. Matthews*, 857 S.W.2d 57, 59 (Tex. App.–Houston [1st Dist.] 1003, writ denied). *See also Querner v. Rindfuss*, 966 S.W.2d 661, 666 (Tex. App.–San Antonio 1998, pet. denied).

[27] *See, e.g., Lopez v. Munoz, Hockema & Reed*, 22 S.W.3d 857, 859 (Tex. 2000) (contingency fee contract). *Wright v. Christian & Smith*, 950 S.W.2d 411, 412 (Tex. App.–Houston [1st Dist.] 1997, no writ) (stating elements of breach-of-contract claim, including damages arising from breach).

IV. Considerations in Purchasing Attorney Professional Liability Insurance

As the areas of legal practice continue to become more specialized, the adoption of collaborative law procedures, arbitration, mediation, and other alternative dispute resolution procedures continue to evolve and become mandatory, and with common law and statutory bases of both quasi-criminal, punitive, and civil liability for the attorney, it becomes even more important for the attorney and law firm to become an educated consumer in considering the purchase of attorney professional liability insurance. In addition to the obvious considerations of deductibles, self-insured retention, and the categories of individuals or entities that may be insured under any given policy, some important points to consider when evaluating the pros and cons of coverages provided for under any policy should also include:

* Does the claims-made policy provide for reporting after the expiration of the policy?
* How are "professional services" or "legal services" defined?
* What constitutes a "claim" under the policy?
* How limited is the definition of "wrongful act?"
* Does the insured retain counsel of its own choosing?
* Does the policy require consent to settle?
* Is there coverage for disciplinary and grievance proceedings?
* Are punitive damages covered?

Examination of four current specimen policy forms written by **St. Paul Fire and Marine Insurance Company** [1st Choice Lawyers Professional Liability Protection (revised 2003)], **Greenwich Insurance Company** [Professional

Liability Insurance for Lawyers Claims Made and Reported Policy (March 2006)], **Great American Insurance Company** [Legal Professional Liability Claims-Made Form (March 1997)], and **Chubb** [Pro Lawyers Professional Liability (April 2004)] reveals that although the market provides choices for carriers, similar coverages are available.

A. Claims-Made Form

Each of the policies are written on a claims-made form. The **Chubb** Pro Lawyers Professional Liability Insurance policy is claims made and not reported. In other words, an insured may report a claim after the expiration of the policy period as long as the insured continues to renew with Chubb.

But, what constitutes a claim? A claim means a "demand that seeks damages" under the **St. Paul** policy. Suit would include a civil proceeding seeking damages, including arbitration (participation mandatory or with insurer's consent) or any other alternative dispute resolution

* civil administration or regulatory proceeding, including a disciplinary proceeding; or

* written requested received to toll or waive statute of limitations relating to a potential claim.

B. Insuring Clause

The coverage agreement or insuring clause is the most important starting point in evaluating the claims-made form.

For example, the obligation of **St. Paul** to its insured is to pay amounts any protected person is legally required to pay as damages for covered loss that (1) results from the performance of, or failure to perform, legal services by or on behalf of any protected person; and (2) is caused by a wrongful act committed on or after any retroactive date of the agreement.

Greenwich and **Great American** modify the **St. Paul** coverage agreement language, to include additional damages and defense or claim expenses proceedings for damages (participation requires insurer's consent).

Greenwich defines claim more broadly, to include "any demand received by you for money, services or any other thing of value arising out of your acts, errors or omissions in providing professional services."

Great American also includes personal injury (a defined term) arising out performance of professional services.

Chubb defines a claim broadly, to include:

* written demand for money or non-monetary relief;

* written demand for arbitration;

* civil proceeding;

arising out of a claim or pre-claim (early-reported) incident that you first become aware of and report in writing during the policy period.

Assuming a claim has been timely reported or made, each policy provides coverage for damages or loss on behalf of the insured, for a wrongful act committed by the insured.

St. Paul defines damages to include compensatory damages imposed by law, and punitive or exemplary damages imposed by law if such damages are insurable under the applicable law. Not included are fines, penalties, forfeitures, sanctions, and legal fees charged or incurred by any insured. The policy pays for some disciplinary proceeding expenses, but no duty to defend in such a proceeding exists. Defense costs are included within, are paid first, and reduce the limits of liability.

Greenwich and **Great American** define damages to mean a monetary judgment or award, or a monetary settlement which Greenwich agrees to on the insured's behalf, but does not include punitive damages, fines, penalties, court-imposed monetary sanctions, or return of legal fees, costs or

expenses.

Chubb defines loss to include compensatory damages imposed by law, and punitive or exemplary damages imposed by law if such damages are insurable under the applicable law, judgments, settlements, pre-judgment and post-judgment interest and defense costs.

C. Professional Services or Legal Services

St. Paul and **Great American** define "legal services" to mean those "professional services performed, or failed to be performed, for others as duties in any of the following capacities, regardless of whether or not a fee is charged for such services:

(1) lawyer, other than a city or county attorney;

(2) arbitrator;

(3) city or county attorney;

(4) lobbyist;

(5) mediator,

(6) notary public;

(7) administrator, conservator, receiver, executor, guardian, trustee, or any similar fiduciary capacity directly connected with the person's practice of law.

In addition to that provided in the **St. Paul** policy, **Greenwich** includes services provided as:

(1) a title agent;

(2) a member of a bar association or other legal or lawyer related ethics, peer review, accreditation, licensing or similar board, committee, or organization; or

(3) an author, but only for the publication or presentation of research papers or similar work and only if the fees generated annually from all such work are less than $25,000.

Chubb includes most of the above, but adds services provided as:

(1) governmental affairs advisor; and

(2) paralegal or legal assistant, solely in connection with the performance of professional services. Chubb expresses within its coverage agreement that it does not apply to the provision of any financial or investment advice.

D. Wrongful Act

Ideally, a broad definition of "wrongful act" is preferred. The **St. Paul** policy, for example, defines the term to include: (1) error, omission, or negligent act; or (2) personal injury offense. **Chubb** broadens the definition somewhat, including any "actual or alleged" act, error or omission committed, attempted, or allegedly committed or attempted, solely in the performance of or failure to perform professional services.

E. Duty to Defend

The policies similarly address the duty to defend. The duty to defend extends against a claim or suit for loss covered by the agreement, even if the allegations of suit or claim are groundless, false, or fraudulent. When the insurer defends, it should pay defense expenses incurred by or for the insured.

The right to select defense counsel is not a right afforded the insured; rather, the right is retained by **Greenwich**, **Great American** , and **St. Paul** under their policies.

Some policies provide for the right to appeal a judgment for covered damages, and insurers will pay the cost of an appeal bond, but only for that part of the judgment for covered damages. Importantly, most policies state that the insurer will not be the principal under any appeal bond, and the insurer does not have the duty to furnish an appeal bond. The bond costs are supplemental to the limits of coverage.

Unlike the other three carriers, **Chubb** places

the duty to defend claims and to retain qualified counsel onto the insured, with prior written consent. **Chubb** does give the insurer the right to associate with the insured, and requires that it be consulted in advance regarding investigation, defense, and settlement of claims. **Chubb** may withhold consent to representation of one insured by another insured, or if more than one insured is involved in a claim, to withhold consent for separate counsel, unless there is a material actual or potential conflict of interest among the insureds.

F. Disciplinary Proceedings

The policies treat disciplinary proceedings consistently. No duty to defend against any disciplinary proceeding generally exists under the professional liability policy. Nonetheless, some policies provide for disciplinary proceeding expenses where the proceeding:

(1) results from the performance of, or failure to perform, legal services by or on behalf of any protected person; and

(2) is caused by a wrongful act committed on or after any retroactive date that applies and before the ending date of the policy.

The disciplinary proceeding includes those conducted by any bar association or state regulatory or disciplinary official or agency.

The **Greenwich** policy, for example, limits defense expenses to a maximum of $30,000 per policy period, while **Great American** limits expenses to $10,000 per policy period, but under both policies, the amounts paid do not reduce the limits of liability. Other policies are silent on maximum limits for defense expenses associated with disciplinary proceedings.

Great American requires the insured to communicate within a reasonable period the consent or objection to any claim settlement it proposes. But if an objection to any settlement is made, the insured must take full responsibility for, and pay for, further defense and settlement of the claim. Under these circumstances, the insurer is obligated to the amount proposed for settlement and claim expenses incurred through the time of receipt of the objection.

G. Defense Expenses

The policies also similarly define defense or claim expense. Importantly, defense costs are included within, are paid first, and reduce the limits of liability under each of the policies. Defense or claim expenses are those expenses that result directly from the investigation, defense, or appeal of a specific claim or suit, and include: fees, costs, and expenses of hired or appointed attorneys; costs of proceedings involved in the suit, including fees of court reporters, arbitrators and mediators; fees for witnesses; and independent experts and special investigator fees, costs, or expenses incurred by attorneys appointed by the carriers.

H. Consent

Another important consideration is how the carrier will handle settlement and issue of consent to settle. The **St. Paul** policy gives St. Paul the right to settle any claim or suit, however, it won't agree to the final settlement of any claim or suit without the insured's consent. If consent is refused, the policy will not pay more than the combined total of the damages and defense expenses incurred after the refusal to give consent.

Similarly, **Greenwich** will not settle without consent, and if the insured refuses to consent within a reasonable time or if consent is not provided, liability for the claim will not exceed the amount for which the claim could have been settled, plus defense expenses incurred up to the date of the refusal of consent or election to contest the claim.

Chubb places the duty to defend claims and to retain qualified counsel onto the insured, with prior written consent. **Chubb** does give the insurer the right to associate with the insured, and requires that it be consulted in advance regarding investigation, defense, and settlement of claims. **Chubb** may withhold consent to representation of one insured by another insured, or if more than one insured is involved in a claim, to withhold consent for separate counsel, unless there is a material actual or potential conflict of interest among the insureds.

Chubb requires that the insured not settle or offer to settle or incur any defense costs, to assume contractual liability, or admit liability without its prior written consent.

I. Additional Payments

All the policies include supplementary or additional payments provisions.

St. Paul provides for express additional payments, including: (1) its expenses other than defense expenses; (2) cost of bonds to release property used to secure a legal obligation, but only within limit of coverage; (3) expenses incurred by insured; (4) taxed costs; (5) prejudgment interest accruing before the date of a settlement offer to pay policy limits; and (6) post-judgment interest.

Greenwich considers the disciplinary proceedings defense expenses as supplementary, as well as other payments for loss of earnings and reasonable expenses incurred at Greenwich's request for attendance at trial or other proceedings. The reimbursement is capped at $500 per day, $5,000 per claim, and $25,000 per policy period.

Great American similarly covers lost earnings and reasonable expenses incurred at its request, but these payments at $250/$5,000/$20,000.

J. Exclusions

Similar exclusions are contained within the attorney's professional liability policies.

The **St. Paul** policy excludes:

(1) criminal, dishonest, or fraudulent wrongful acts or knowing violation of rights or laws; and

(2) known wrongful acts.

Nonprofit services liability also excludes (1) claims or suits brought or made by the nonprofit entity; (2) ERISA or similar state violation; and (3)

Chubb further excludes any claim based on:

(1) actual or alleged infringement of any certification mark, copyright, patent or trademark failure to obtain or maintain insurance or bonds.

In addition, **Greenwich** excludes any claim:

(1) arising out of activities as an investment advisor or accountant;

(2) arising out of activities as a fiduciary under ERISA;

(3) seeking damages for physical harm, sickness or death of any person;

(4) seeking damages for destruction, diminution in value or loss of use of tangible property;

(5) by an insured against another insured;

(6) involving liability of others assumed under contract or agreement;

(7) arising out of loss or destruction of or diminution in value of any asset in the insured's care, custody or control, or out of the misappropriation of or failure to give an account of any asset in the insured's care, custody, or control, including commingling of client funds.

Great American further excludes:

(1) acts, errors, or omissions while acting as a securities, real estate, or insurance broker, dealer, agent, or trader;

(2) acts, errors, or omissions while acting as a public officer or employee of governmental or quasi-governmental body, subdivision, or agency;

(3) sickness, disease, disability, disfigurement; and

(4) claim asserted against the insured as a beneficiary or distributee of a trust or estate.

(including collective or service marks), trade secret, trade name, trade dress, misappropriation of ideas or other intellectual property; and

(2) the insured having gained any profit, remuneration or advantage to which he was not legally entitled.

V. **Conclusion**

While remedies for clients continue to expand under the common law and statutory law, options for expanded coverage under professional liability insurance for attorneys should not be expected. Rather, the market provides similar coverages, exclusions, and duties of the insurer and the insured. Until a shortage of the availability of coverage exists, this historical market trend will not likely change. Consequently, careful evaluation of the attorney's practice areas, ethical responsibilities to his or her client, and areas of potential liability must be undertaken when making a determination or selection of legal professional liability insurance.