



**LAWYERS'
MUTUAL**
INSURANCE COMPANY

FIRST TIME BUYER'S GUIDE CALIFORNIA LEGAL MALPRACTICE INSURANCE

CAUTION: This material does not establish the terms and conditions of coverage provided by Lawyers' Mutual Insurance Company or any other professional liability carrier. It is an attempt to present background information for attorneys considering purchasing legal malpractice insurance in California. As the title suggests, it is intended for those new to such purchases and is by no means an exhaustive discussion of the topic. The materials presented should provide a foundation for the reader. We invite you to contact us via email info@lawyersmutual.com or visit our website www.lawyersmutual.com for detailed information concerning the variety of policies we provide and assistance in determining which program would best meet your professional liability needs.

First Time Buyer's Guide California Legal Malpractice Insurance

Introduction

If you are a law student, a recently admitted lawyer, a lawyer leaving an in house or government post or leaving a position in big law, you are most likely shopping the market for legal malpractice insurance for the first time. Legal malpractice insurance is considerably different from other insurance products you may have purchased in the past, such as automobile coverage. This Guide highlights why you should consider having legal malpractice insurance, the purpose of such coverage, key considerations in selecting the insurance company that will protect you and your clients, and several important terms critical to a thoughtful and careful decision. Before we get to these topics, we expect you are wondering about the cost of this coverage. While there are numerous variables that go into the pricing of legal malpractice coverage, sole practitioners in California who have been admitted less than 36 months can get coverage from an 'A' rated, admitted carrier for a premium as low as \$500 their first policy year¹.

Why California lawyers should consider having legal malpractice insurance.

- Rule of Professional Conduct 1.4.2²
- It helps you compete – disclosing to your potential client that you do not have coverage (as required by Rule 1.4.2) may not positively impress them and they may choose someone else who carries insurance.
- Many government and corporate clients require it.
- State Bar Certified lawyer referral services require it.
- You are being a responsible lawyer and protecting your clients.
- You are protecting your family and assets.
- Defending a claim regardless of fault is expensive. The cost of defending a legal malpractice case may well exceed a year of your firm's revenues.
- Neither a PC nor LLC protects or insulates you personally from legal malpractice suits/judgments.
- CLE and Lawyer-to-Lawyer Hotline support may be offered to assist you in preventing claims.

¹ A summary of Lawyers' Mutual Insurance Company's Strong Start Program (SSP) is appended to the Guide.

² Rule 1.4.2 is appended to the Guide.

What is legal malpractice insurance?

Legal Malpractice Insurance is:

Legal malpractice insurance is also known as an errors and omissions (E&O) insurance and is designed and intended to defend and indemnify a lawyer for an error or omission in the performance of legal services for others. In other words, if you make a mistake in your legal practice and your client makes a claim or files a lawsuit against you, this is a type of matter that would be contemplated under this policy. Each policy has variations in coverage. It is imperative you carefully consider the terms to ensure that you completely understand what you are purchasing. This Guide is NOT a substitute for your careful consideration of this important purchase.

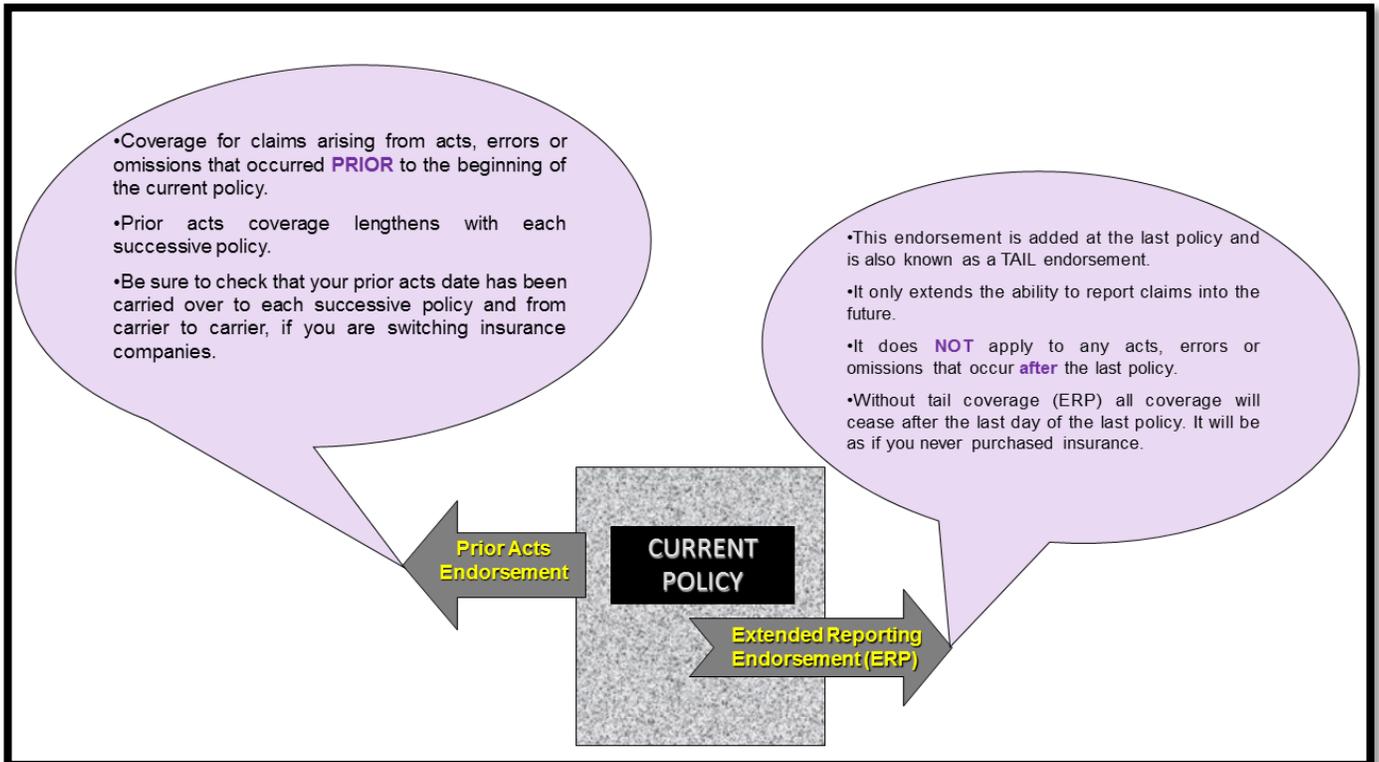
Legal Malpractice Insurance is not:

- Workers' Compensation - example: support staff gets carpal tunnel syndrome from work-related keyboard tasks.
- Employer Liability – also referred to as EPLI or employment practices liability insurance (example: wrongful termination or harassment claim against you as an employer).
- Property Casualty - also referred to CGL or comprehensive general liability (example: office fire, theft, etc.).

Step 1: Information to Know Before Starting the Purchase Process

Certain terms and concepts need to be understood before you begin the process of procuring legal malpractice insurance.

Prior Acts Chart



• **Claims-Made and Reported**

Professional liability policies (e.g. legal malpractice) are typically issued as claims-made and reported policies. These are the only types of policies on the market. It is not an occurrence policy which is like your automobile coverage. It is very important to understand this type of policy and how it operates.

An occurrence policy provides coverage for liability arising from events which occur during the policy period, regardless of when the insured is sued. For example, let's assume you had your car insured by Company A last year and Company B this year. You had an accident last year, and a personal injury complaint was filed against you this year by someone who was injured in the accident. As automobile liability coverage is written on an "occurrence" basis, the insurance policy in effect when the accident ("occurrence") happened, rather than the insurance policy in effect when you were sued, will provide coverage for the lawsuit.

For a claims-made policy however, the policy which provides coverage for a lawsuit brought against the insured is the policy in effect when the claim is made, regardless of when the errors giving rise to the claim occurred (subject to the discussion on prior acts below).

A claims-made and reported professional liability insurance policy has a two-prong requirement for coverage to potentially attach. First, the claim must be first made during the policy period; and second, the claim must be reported to the insurer (typically in writing) during the policy period.

What constitutes a claim under claims-made policy depends on the “Claim” definition in the policy. Typically, any demand for money against the insured (for example, “I think you committed malpractice. Pay me \$1,000 or I will sue you”) will qualify as a “Claim”. The applicable legal malpractice policy will be the policy in effect when the claim is first made (e.g., a demand for money is made in January, which the insured rejects, and the claimant then files a lawsuit against the insured in July – the policy in effect in January, when the claim was first made rather than the one in July, would be the applicable policy).

However, the claim must not only be first made in the policy period, but also must be reported to the insurer during the policy period. The policy typically describes how the reporting should be done, usually requiring notice of a claim in writing. It is important to immediately report any claim to the insurer, as the making of the claim and the reporting of that claim must both be during the policy period for coverage potentially to attach. If a claim is made in January, the policy expires in March and a renewal policy is issued, then the claim is reported to the insurer in May, there will be no coverage, because the claim and the reporting did not take place in the same policy period.

- **Prior Acts Date or Retroactive Date**

The prior acts date or retroactive date relates to the date of the acts, errors or omissions giving rise to a legal malpractice claim. This is unrelated as to whether a “claim is timely made and reported to the insurer. Most legal malpractice policies will identify a “prior acts date” or a “retroactive date” and coverage will be provided only for a legal malpractice claim (which must still be first made and reported during the policy period) which is based on acts, errors or omissions taking place after that prior acts date or retroactive date. Some policies will instead have a prior acts exclusion, which excludes coverage for any claims predicated on acts, errors or omissions occurring before the prior acts date or retroactive date.

The prior acts date or retroactive date often will be the inception date of the first policy issued by the insurer to the insured. For each subsequent consecutive policy, the period of time during which the acts, errors or omissions may occur is increased, as the prior acts date or retroactive date usually continues to be the inception date of the first policy.

Some insurers offer prior acts coverage, typically for an increased premium. Prior acts coverage is not always easily secured by new insureds and may not be available to insureds who had no prior professional liability coverage or gaps in their prior professional liability insurance. Insureds with a history of multiple claims may also find it difficult or impossible to purchase prior acts coverage.

- **Extended Reporting Endorsement or Tail**

Another form of coverage that bears on the concept of prior acts coverage is the extended reporting period endorsement (ERP), commonly referred to as “tail coverage.” The ERP is an endorsement that is put on the last policy to allow reporting of claims after the policy has expired. It is usually purchased by lawyers who are retiring or leaving private practice or by firms that are ceasing operations or dissolving. Without this endorsement extending the

reporting period, all coverage will cease on the day the policy ends (since it is a claims-made and reported policy). Accordingly, a claim reported after the policy expired would not be covered, even though there was a policy in effect at the time of the alleged error. It is imperative to purchase an ERP when retiring, closing a practice or the like.

The terms of the ERP will vary among insurers as will the length. It can vary from a 1- year ERP to an unlimited term and costs change accordingly.

- **Diminishing or Burning Limits**

While certain policies provide for some defense costs outside of limits, if that allowance is exhausted, every dollar of fees and costs spent on defense reduces the amount of policy limits, available for settlement or payment of a judgment. For example, if you purchase a \$100,000 per claim policy and defense costs are \$50,000 and the settlement offer is \$75,000, only \$50,000 of the settlement would be covered by the policy.

The concept is simple. The impact of diminishing limits on the ability to defend or settle is substantial. A thorough and well mounted defense may not be sustainable if the limits are exhausted before an appropriate settlement can be achieved, dismissal by way of motion is obtained, or a defense verdict is reached.

Additional sums outside the limits that can be used for defense are sometimes included in the policy and if not, can sometimes be purchased for additional sums. If such a Claims Expense Allowance or Defense Expense if available, make sure to find out what that amount is.

- **Consent to Settle**

To some attorneys, an important policy provision is a requirement that as an insured they have the right to consent to settle. By comparison, an automobile liability policy does not provide the insured with the contractual right to limit settlements only to those to which they provide their consent. Some legal malpractice policies do not provide the insured such a right. The insurer providing legal malpractice insurance coverage at low levels of policy limits, e.g., \$100,000, may very well retain full discretion to settle a claim without seeking the consent of its insured.

The underlying reason for consent to settle provisions is to give the insured the right to protect his or her reputation and to prevent the assumption of admitted liability.

Step 2: Other considerations before you apply for insurance

- **Direct vs. Brokered Insurance**

Consumers of legal malpractice insurance have the option of purchasing their coverage directly from a carrier or using agents or brokers. As a mutual insurance company, Lawyers' Mutual's policyholders are its members/owners. Given this connection, it is no surprise that Lawyers' Mutual and other direct writers are reputed to provide excellent customer service.

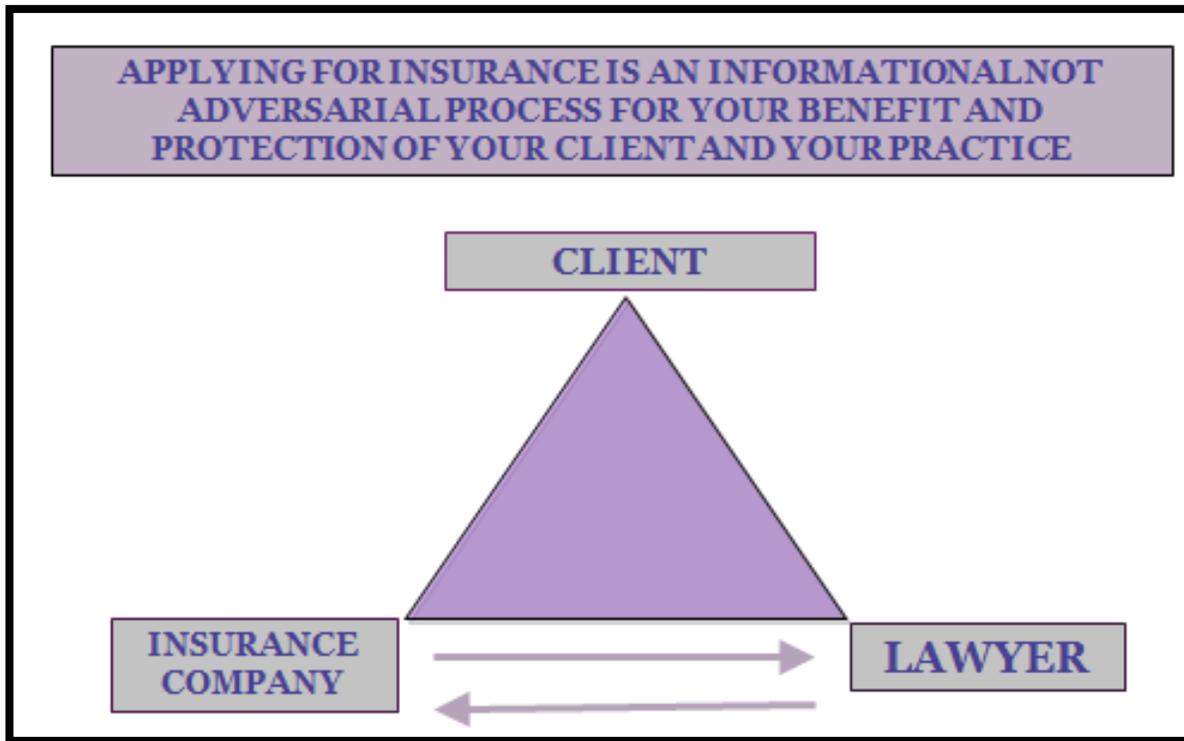
Another benefit of dealing with direct writers is that you are getting the information directly allowing for efficiency regarding the application process and claims handling.

Some consumers prefer to use an agent or broker to assist them with the purchase of legal malpractice insurance. Agents are traditionally considered to be representatives of insurance companies who are authorized to solicit applicants for coverage. Brokers are typically considered to be working for the applicant/ client to ascertain its needs and advise them of the most advantageous programs available to meet its needs.

- **Admitted vs. Non-Admitted Insurers**

The financial status and solvency of the insurer/carrier from which the applicant is seeking coverage should be considered when purchasing legal malpractice insurance. “admitted” means that the CA Department of Insurance (DOI) has reviewed and approved the carriers’ rates, reserves and method of doing business within the state. Further, that carrier will be governed by the laws of the state and regulated by the DOI. Whereas a “non-admitted” carrier is not regulated, not approved or bound by the DOI. An admitted insurer is preferable, although an attorney with an adverse claims history might not be considered a desirable risk for such an insurer. Coverage obtained from a non-admitted insurer will generally be costlier than that offered by an admitted insurer. In addition, only insureds with an admitted carrier enjoy the benefits of the California Insurance Guarantee Association (CIGA) in the event the insurer becomes insolvent.

Step 3: The Application and Process



Applying for insurance is an informational - not adversarial - process designed for your benefit and the protection of your client and your practice.

The importance of the application cannot be over-emphasized. The responses are deemed to be true to the best of the applicant's knowledge and are material to the carrier who is relying upon them to make their decision to insure you. The answers need to reflect the information available to each member of the applicant firm. Therefore, it is important to poll each member of the firm regarding those questions which require individual input, such as, "Do you know of any circumstances that may lead to a claim?" or "Are you providing legal services to individuals or entities that are not clients of the firm?"

Of course, there are many other questions which comprise the application which must be responded to with accuracy. The application is generally incorporated into the policy and customarily is a material consideration for the issuance of the policy and is generally made a part of the policy itself.

Material misrepresentations in the application may provide a basis for denying coverage or rescinding the policy.

Example: When asked if you are aware of any claims you fail to report a matter in which you just advised the client that the statute of limitations was missed on their case.

During the application process, you may be asked to provide additional information, which should be forthcoming and responsive. It is vital information that the carrier seeks to correctly assess the risk and premium that will be due.

- **What factors are considered in calculating premium?**

Different carriers calculate premium using a variety of factors including limits requested, deductible, number of lawyers in the firm, the prior acts date you are carrying forward from a prior policy, number of years in practice, your areas of practice, the geographic location of your practice, your receivables, your calendar system, client intake procedures, continuing education, claims history, discipline history, outside interests and many other factors. It is prudent to ask the carrier which factors they use to understand how your policy is rated.

- **Policy Limits**

Not unexpectedly, the cost of a policy is, in part, determined by the policy limits requested. These policies usually carry a per/claim limit and aggregate limits for all claims that are paid out in a given policy year. For example, a sole practitioner or small firm may consider limits of \$100,000 per claim to be adequate. The companion aggregate or total available for all claims made and covered by the policy during the terms thereof would commonly be \$300,000. A carrier typically has a range of limits it will offer and something you need to consider.

When evaluating the amount of policy limits that will provide adequate protection, consider your practice areas, the value of the matters you handle, the value of your personal assets.

Another consideration is whether the policy offered has limits that will diminish immediately or whether an allowance for defense exists or can be purchased outside the limits.

Ultimately, this is a personal decision to be made after factoring in your budget, asset protection needs, type of practice, etc. A wide range of policy limits (from \$100,000 to multi-millions) are available to solo practitioners and small firms.

- **Policy Contract**

Be sure to review the features of the contract that will be used. Read the contract and ask about any special provisions, requirements, or restrictions. Check on the availability of prior acts coverage and tail options.

- **Quotation**

Once you have completed the application process and provided all requested information, the application will be given to an underwriter for approval. After approval, a quotation is generated which sets forth the limits, deductible, prior acts date (if any) as well as personal data. Before accepting and/or signing the quotation, make sure to check all the terms listed for accuracy. The premium due will be listed and typically it may be paid in full or financed. Accept the quotation and remit appropriate payment to the carrier so that the policy can be issued.

- **How do I pay for the policy and can the policy be financed?**

The carrier you select may have different options including financing in house, financing with an outside company, online or automatic pay or payment plan. Again, it is prudent to check with the carrier you selected to purchase policy from. Brokers may be able to offer different options as well.

Step 4: Final Steps Following the Purchase of the Policy

After executing the quotation and making payment, the insurance company will issue your Declarations and policy.

- **Declarations Page**

A snapshot description of the policy you purchased is found on the Declarations. Generally, after purchasing a policy, the Declarations summarizes items statutorily required and other important details of your policy. The type of policy effective date, policy limits, and the prior acts/retroactive date, if any, may all be specified on the Declarations. When you receive it, read it to make sure all the information is correct as accepted on your quotation.

Conclusion

This guide is by no means intended as an exhaustive look at the topic; however, we hope to have provided some useful resources and information in preparation for this important purchase. We invite you to contact Lawyers' Mutual Insurance Company at www.lawyersmutual.com or (818) 565-5512 for detailed information concerning the variety of policies we provide and assistance in determining which program would best meet your professional liability needs.

Rules of Professional Conduct

**Rule 1.4.2 Disclosure of Professional Liability Insurance
(Effective November 1, 2018)**

(A) A lawyer who knows* or reasonably should know* that the lawyer does not have professional liability insurance shall inform a client in writing, * at the time of the client's engagement of the lawyer, that the lawyer does not have professional liability insurance.

(B) If notice under paragraph (a) has not been provided at the time of a client's engagement of the lawyer, the lawyer shall inform the client in writing* within thirty days of the date the lawyer knows* or reasonably should know* that the lawyer no longer has professional liability insurance during the representation of the client.

(C) This rule does not apply to:

- (1) a lawyer who knows* or reasonably should know* at the time of the client's engagement of the lawyer that the lawyer's legal representation of the client in the matter will not exceed four hours; provided that if the representation subsequently exceeds four hours, the lawyer must comply with paragraphs (a) and (b);
- (2) a lawyer who is employed as a government lawyer or in-house counsel when that lawyer is representing or providing legal advice to a client in that capacity;
- (3) a lawyer who is rendering legal services in an emergency to avoid foreseeable prejudice to the rights or interests of the client;
- (4) a lawyer who has previously advised the client in writing* under paragraph (a) or (b) that the lawyer does not have professional liability insurance.

Comment:

- [1] The disclosure obligation imposed by paragraph (a) applies with respect to new clients and new engagements with returning clients.
- [2] A lawyer may use the following language in making the disclosure required by paragraph (a), and may include that language in a written* fee agreement with the client or in a separate writing:
"Pursuant to rule 1.4.2 of the California Rules of Professional Conduct, I am informing you in writing that I do not have professional liability insurance."
- [3] A lawyer may use the following language in making the disclosure required by paragraph (b):
"Pursuant to rule 1.4.2 of the California Rules of Professional Conduct, I am informing you in writing that I no longer have professional liability insurance."
- [4] The exception in paragraph (c)(2) for government lawyers and in-house counsels is limited to situations involving direct employment and representation, and does not, for example, apply to outside counsel for a private or governmental entity, or to counsel retained by an insurer to represent an insured. If a lawyer is employed by and provides legal services directly for a private entity or a federal, state or local governmental entity, that entity is presumed to know* whether the lawyer is or is not covered by professional liability insurance.