

Lawyers Professional Liability Insurance: Understanding Coverage Limits

By JoAnn Hathaway

You have just passed the bar and know you need to obtain lawyers professional liability insurance/malpractice insurance (LPL) as you open your new law firm. Your first question to your agent is, “What limits should I obtain?” A wise agent would respond, “That depends.”

There are numerous factors to consider when deciding on policy limits. Also, an applicant must have a full understanding of the type and amounts of available limits and know the application to payments under the terms of a policy.

The term “policy limit” refers to the amount of coverage a policy provides. LPL insurance carriers offer a variety of policy limit options, which often include two components: a per-claim limit and an aggregate limit.

A per-claim limit is the most a carrier will pay for a single claim made during a policy period. It is important to refer to the policy language regarding how a carrier defines a single claim or related claims, the scope of which is routinely defined in the policy-insuring agreement or in its conditions section. Common policy language

provides that a per-claim limit is the most the carrier will pay for all claims arising out of the same act, error, or omission regardless of the number of claimants.

The aggregate limit is the most a carrier will pay for all claims made during a single policy period. It is common to see a per-claim limit equal to the aggregate limit, otherwise referred to as a combined single limit. Larger law firms generally have an aggregate limit several times greater than the per-claim limit due to the very real likelihood the firm will experience more than one claim during a policy period.

There are two types of payments available under an LPL policy. The first is payment made for judgments, awards, and settlements for which an insured is legally liable that arise from professional services. The second is the payment that applies to expenses incurred to defend claims.

It is important to understand how claims expenses are handled under the policy terms and the options for claim expense coverage. Claims expenses are generally defined in an LPL insurance policy as costs the carrier will incur for investigating, adjusting, and defending claims including, but not limited to, defense costs, expert fees, mediation, arbitration, and court costs. In-house fees for paying claims personnel and other associated expenses are almost always absorbed by the insurance carrier as a cost of doing business and are not typically charged against a policyholder’s limits for claims expenses.

An LPL insurance policy can either include or exclude claims expenses within its policy limit. When a policy limit includes claims expenses (which is generally the case), it means the policy has only that claim limit available for both indemnity payments and claims expenses. This type of

policy is often considered a declining limits policy or a cannibalizing policy.

Some carriers provide for payment of defense costs in addition to the policy limits, commonly referred to as claim expenses outside of limits (CEOL). Generally, this type of coverage, if available, is entered into by endorsement for an additional premium. Endorsing CEOL onto a policy can be extremely advantageous to an insured. For example, consider the following scenario:

A claim is asserted against attorney Smith, the insured, seeking damages of \$300,000. Smith’s LPL insurance policy has a per-claim limit of \$300,000 inclusive of both indemnity payments and defense costs. Assigned defense counsel is zealously representing Smith and encouraged by her carrier to engage in aggressive discovery on her behalf.

Each time defense counsel submits a quarterly billing statement to Smith’s carrier for services rendered in her defense, she sees her insurance limit shrinking, resulting in more potential personal exposure to her for a claim settlement or payment of a jury verdict. The protection she sought by purchasing an LPL insurance policy is dwindling, as are the hours of sleep Smith gets each night due to worrying about her financial exposure.

Smith’s defense counsel may be in a difficult situation. Often working closely with and guided by carrier claims personnel, he realizes that the more hours he bills for discovery, the lower the protection for his client.

These issues can be alleviated with CEOL. Legal malpractice actions can be costly to defend. Spending the additional money for a CEOL-endorsed insurance policy is worthwhile.

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Deductibles and self-insured retentions

The deductible or self-insured retention an attorney chooses can have a big impact on payments made under the terms of an LPL insurance policy, so it's fitting that they be addressed together.

While similar, a deductible and self-insured retention are not the same. It is important to understand how they differ to determine, if given an option to select, which is most beneficial.

Under self-insured retention, the insurer usually has nothing to do with losses that do not penetrate its attachment point. The insurer may, however, require notification when a claim is reserved for an amount that pierces the attachment point.

Under a deductible, the insurer pays every loss up to the maximum limit of liability and is reimbursed by the insured up to the amount of the deductible. A deductible imposes a specific layer of risk onto the insured, which is almost always the primary layer above which insurance limits attach. Maintaining a deductible is common within the LPL insurance industry. However, there are nuances within policy types that deserve to be explored and further defined.

When comparing LPL policies, it is important to review how the deductible is applied to the policy limits. Some policies define a limit to exclude a deductible amount, meaning that the deductible does not reduce the carrier's liability limit. Others include the deductible within the policy limit.

Policies are almost always written so deductibles do not stack. Specifically, policy form provisions specify that only one deductible applies per wrongful act. Therefore, if a single act, error, or omission results in more than one claim, only one deductible would apply to the resulting claims.

Deductibles under LPL insurance policies generally apply to both indemnity payments and claims expenses. Many insureds would expect this deductible application under an insurance policy.

Some carriers offer a deductible payment option called first-dollar defense. Provided by way of endorsement, this policy add-on can save an insured money by declaring

that an insured's deductible does not apply to defense costs.

Typically, no conditions are associated with a disgruntled client filing a complaint against his or her attorney. Claims without merit are commonplace and need to be defended. Even if these matters are dismissed by way of summary disposition, an insured's carrier will retain counsel, resulting in defense costs associated with the claim.

If an insured has first-dollar defense endorsed onto his or her policy, the deductible will not apply to defense costs. While attorneys often think, "It will never happen to me," when it does, having first-dollar defense—and no out-of-pocket expenses—is a coverage option they are more than happy they selected.

The bold new world of deductibles

Every year, LPL insurance carriers seem to get more creative with the deductible options they offer. This is good for an insured, because the less out-of-pocket money needed to respond to a claim, the better.

Current trends find carriers offering standard coverage, and not necessarily by endorsement, in these instances:

- A deductible that applies to the total amount of all claims, applying to the payment of damages only.
- A deductible that is waived if a ruling of no liability is obtained.

- A separate deductible that applies to each claim made during the policy period.
- A deductible that is applied in the aggregate, meaning that only one deductible is charged during a policy period, regardless of the number of claims.
- A deductible that does not apply to the first \$5,000 of claims expenses incurred by the carrier for each claim made during the policy period.
- A deductible that is reduced by half if a claim is resolved by formal mediation within six months from the date it is reported to the carrier.

Attorneys often choose high deductibles because they think they will never need to report a claim and pay a deductible because it lowers their overall insurance premium. Getting a handle on deductible options can help an attorney make informed, wise, money-saving policy choices.

Insurance limits choices can only be made once one understands the insurance carrier's application of limits to claims and claims expenses. Working with an experienced LPL insurance agent is the first step in helping you through the insurance selection process. Take the time to do your homework and read your policy choices; you'll be happy you did in the event of a claim. ■

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