Outside Counsel

Lawyers Professional Liability Insurance: Coverage Issues

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Although insured lawyers and their insurers are sophisticated groups, many of the former seem willing to purchase their professional liability insurance solely on the basis of price and without regard to subtle but important differences between policies, and many of the latter seem willing to accept the determination by the New York State insurance department that Insurance Law §3420(a) applies to such policies. This article explores some of those issues.

Insureds

Claims Made/Reported. The insuring agreements in the strictest types of policies require that the claim be both made and reported during the policy period.[1] While the cases in some states deem that requirement to be against public policy, see R. Mallen & J. Smith, Legal Malpractice §38:14 (2014 ed.), the New York courts have upheld such clauses. See *Travelers Indemnity Co. v. Northrop Grumman Corp.*, slip opinion (S.D.N.Y. 2013); *Liberty Insurance Underwriters v. Perkins Eastman Architects*, 2011 WL 1744218 (Sup. Ct., N.Y. Co. 2011); *Checkrite Ltd. v. Illinois National Insurance Co.*, 95 F.Supp.2d 180 (S.D.N.Y. 2000); but see NYSID General Counsel Opinion 7-31-2003 (#2) (purporting to deem this requirement to be a violation of Regulation 121, 11 N.Y.C.R.R. §73, which sets forth minimum standards for such policies).[2] The fact that the insurer may have sustained no prejudice is irrelevant for purposes of determining compliance with the claims made and reported clause. See Insurance Law §3420 (a)(5).[3]

Somewhat less strict are those policies which require that the claim be made during the policy period but allow it to be reported either during the policy period or within 60 days thereafter.[4]

Still more liberal are those policies which require that the claim be made during a policy period and reported during either that policy period or any subsequent renewal thereof. I am aware of multiple instances where the insurance department has, at least in the context of lawyers professional liability (LPL) policies, required insurers to include an amendatory endorsement to that effect. The trigger date for this type of policy, as well as those discussed above, is

generally the date on which the claim or potential claim is reported.[5]

At the end of the spectrum are pure claims made policies, which (as the name suggests) are triggered by the timing of the claim, so long as it is reported as soon as practicable (but often not specifying a particular end-date for such reporting). See R. Mallen & J. Smith, Legal Malpractice §38:14 (2014 ed.). In this scenario, the making of the claim, rather than its reporting, is generally the salient date.

Prior Knowledge. Policies typically include language, in the insuring agreements or the exclusions, which bars coverage for claims or potential claims as to which, on the inception of the first policy issued by the insurer and continually renewed thereafter, any insured had reason to foresee the same or to believe that any insured had breached a professional duty giving rise thereto. See *Fogelson v. Home Insurance Co.*, 129 A.D.2d 508, 514 N.Y.S.2d 346 (1st Dept. 1987).

Here, too, however, not all policies are alike, and the practitioner should be aware of the distinction that exists in some policies which impose a new prior knowledge requirement as of the inception of each new policy renewal.

This is particularly significant because, unlike late notice (but like claims made and reported), there is no necessity for an insurer to demonstrate prejudice in order to deny coverage based on prior knowledge.

Fraud. Although all LPL policies contain a fraud exclusion, the particulars frequently differ.

Most policies contain a defense exception to the fraud exclusion (or an equivalent provision that the exclusion will not apply until there has been an admission or final adjudication of fraud); in other words, the insurer will pay for the insured's defense until such time as fraud is established.

Some others provide that the insurer will not defend but will reimburse the insured for defense costs if it is established that the insured did not commit fraud.

However, the strictest of all policies contain an absolute fraud exclusion, under which the insurer will neither indemnify nor even defend or reimburse if the complaint contains allegations sounding purely in fraud.[6]

Regulation 107. Regulation 107, 11 N.Y.C.R.R. §71, sets forth standards for determining whether, or to what extent, defense costs can erode the policy limits (i.e., how much is left for indemnity with respect to any judgment or settlement) or to be applied to the deductible (i.e., how much of defense costs is the insured's responsibility).

The basic rules are as follows: First, for policies with a per-claim limit of less than $500,000, defense costs cannot be applied to the policy limits or the deductible. Second, for policies with a per-claim limit of at least $500,000 but less than $5 million, defense costs can be applied to 50 percent of the policy limit and 50 percent of the deductible. Third, for policies with a per-claim limit of at least $5 million, or a per-claim deductible of at least $100,000, defense costs can be applied to 100 percent of the policy limit and 100 percent of the deductible.[7]

All of these variations affect the price of the policies, but cost is not everything and must be balanced against the potential for uninsured risk. Policies must be read and understood before an informed purchasing decision can be made.

Insurers

Late Notice and Prejudice. For decades, the law in New York (unlike most states) had been that an insurer could deny coverage based on the insured's late notice in reporting a claim or occurrence even if the insurer could not demonstrate prejudice as a result of the delay. *Great Canal Realty Corp. v. Seneca Insurance Co.*, 5 N.Y.3d 742, 800 N.Y.S.2d 521 (2005) (occurrence); *Argo Corp. v. Greater New York Mutual Insurance Co.*, 4 N.Y.3d 332, 794 N.Y.S.2d 704 (2005) (claim or lawsuit); see also *Unigard Security Insurance Co. v. North River Insurance Co.*, 79 N.Y.2d 576, 584 N.Y.S.2d 290 (1992); *Security Mutual Insurance Co. v. Acker-Fitzsimons Corp.*, 31 N.Y.2d 436, 340 N.Y.S.2d 902 (1972).

That changed in 2008 with the enactment of an amendment to Insurance Law §3420 which purported to require prejudice for claims under policies issued and delivered after Jan. 17, 2009. Or did it?

Section 3420(a) now contains a new subdivision (5) which requires that all policies insuring against "injury to person" or "injury to property" contain the following (or more favorable) language:

> A provision that failure to give any notice required to be given by such policy within the time prescribed therein shall not invalidate any claim made by the insured, injured person or any other claimant, unless the failure to provide timely notice has prejudiced the insurer, except as provided in paragraph four of this subsection.[8]

Thus, on its face, the amendment applies only to policies covering "injury to person" or "injury to property."

There is no doubt that those terms refer to many types of insurance policies including, inter alia, general liability policies and certain types of professional liability policies (e.g., medical malpractice). However, there is arguably an issue as to whether LPL policies fall within the purview of §3420(a)(5).

The state insurance department has purported to address this issue, taking the position that this amendment applies to all liability policies (presumably including LPL policies). See Circular Letter No. 26 (2008) and Office of General Counsel Opinion No. 09-01-05 (2009). However, that letter and opinion offer no reasoning or guidance concerning the basis for their conclusions.[9]

It seems logical to conclude that the insurance department deems an LPL policy to be within the scope of section 3420(a)(5) because it contains "personal injury" coverage and/or because it constitutes a "personal injury liability insurance policy" under Insurance Law §1113(a)(13).

"Personal injury" is defined in New York General Construction Law §37-a to "include[] libel, slander and malicious prosecution." LPL policies do, indeed, typically afford such coverage. However, that is a different term, which is entitled to a different interpretation, than "injury to

person." See generally, *In re Motors Liquidation Co.*, 447 B.R. 142 (S.D.N.Y. 2011). Indeed, LPL policies generally exclude coverage for bodily injury and property damage—terms that clearly seem more akin to "injury to person" and "injury to property."

In addition, "personal injury liability insurance" is defined in Insurance Law §1113(a)(13) as "insurance against legal liability of the insured…incident to a claim of such liability…arising out of death or injury of any person, or arising out of injury to the economic interests of any person, as the result of negligence in rendering expert, fiduciary or professional service." However, that, too, is a different term which is entitled to a different interpretation than "injury to person"—particularly since it is contained in the very same statute.

This issue was addressed in *McCabe v. St. Paul Fire and Marine Insurance Co.*, 25 Misc.3d 726, 884 N.Y.S.2d 634 (Sup. Ct., Erie Co. 2009), aff'd, 79 A.D.3d 1612, 914 N.Y.S.2d 814 (4th Dept. 2010), where the lower court considered this in the related context of an injured party's right to give notice to an insured's LPL carrier under Insurance Law §3420(a)(3). That court held that the injured party had such a right, because an LPL policy is, indeed, one which covers "injury to person." Its reasoning was also predicated upon the fact that the LPL policy covered "personal injury," as a result of which it granted summary judgment in favor of the injured party and against the insurer. The Fourth Department affirmed in an opinion providing no further clarification on this issue.[10]

The Court of Appeals has not weighed in on this subject. Moreover, it appears unlikely that further judicial guidance will be forthcoming inasmuch as insurers appear to have generally acceded to the insurance department's position by including in LPL policies the statutory language from Insurance Law §3420(a)(5) and thereby acknowledging the necessity for a showing of prejudice in order to deny coverage based on late notice.

Perhaps the issue could again be litigated by an insurer with a new policy unwilling to follow the crowd but, instead, prepared to challenge the conventional thinking. Unless and until that happens, the status quo will remain.

Endnotes:

1. This is fundamentally different than a general liability (e.g., homeowners or automobile) policy, the triggering of which is tied to the timing of the occurrence.

2. Of course, that is not the only timing requirement which must be satisfied to invoke coverage, as the insured must still report the matter in a timely fashion within the policy period—or face the consequences of late notice.

3. Nevertheless, prejudice is arguably relevant for purposes of late notice. See Ins. Law §3420 (a)(5).

4. It should be noted that, regardless of the triggering clause, in the event of termination (i.e., cancellation or non-renewal) there is always an automatic 60 day extended reporting period under NYSID Regulation 121, 11 N.Y.C.R.R. §73.

5. The so-called discovery clause allows for the reporting of a potential claim to invoke coverage.

6. Nevertheless, an "innocent insured" clause is typically present even there, which affords coverage to those insureds (other than the alleged active wrongdoer) who did not personally participate in the fraud.

7. In the third category is a further permutation, allowing 100 percent attribution where the policy provides the insured with certain rights—most notably the right to select its own defense counsel.

8. Subsection (4) provides as follows: "A provision that failure to give any notice required to be given by such policy within the time prescribed therein shall not invalidate any claim made by the insured, an injured person or any other claimant if it shall be shown not to have been reasonably possible to give such notice within the prescribed time and that notice was given as soon as was reasonably possible thereafter."

9. The limited statutory history on §3420(a)(5) is also of no help.

10. See also *Romano v. St. Paul Fire and Marine Ins. Co.*, 65 A.D.2d 941, 410 N.Y.S.2d 942 (4th Dept. 1978).
