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Outside Counsel

Risks of Changing Professional Liability Insurers

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Question 1: You have an opportunity to switch your homeowner, automobile or other general liability insurance to another carrier in order to obtain a savings on the annual premium. If the new policy incepts immediately upon the expiration of the old one, should you have any concern about a gap in coverage?

Question 2: Same as above, except the policies involved are your professional liability insurance.

The answer to the first question is that, in general, there is no risk of a coverage gap because homeowner, automobile and other general liability policies are written on an occurrence basis. This means that "the insurable event [is] ... an [act] ... during the policy period, regardless of when the claim is made."[1] Accordingly, so long as there are continuous policies in effect, even through different insurers, all insurable events should be covered.[2]

Coverage Problems

However, the answer to the second question is decidedly different. Most professional liability policies, and particularly lawyers' professional liability policies, require "that the claim both be made and reported within the policy term."[3] They also generally exclude coverage for any claim arising out of acts and omissions occurring prior to the policy period if, prior to the inception of the insured's first policy with that carrier, the insured reasonably should have foreseen that such a claim would be made.[4] This is commonly referred to as a prior knowledge provision.[5] In this context, a switch in carriers exposes the insured to a potential gap in coverage, notwithstanding the fact that continuous policies may be maintained.[6]

For example, consider the availability of coverage for an insured attorney who defaulted in answering a complaint in 2015, and had a claims made and reported policy with one carrier in that year and a similar policy with another carrier in 2016. If the claim was not made against the attorney until 2016, the 2015 insurer could deny coverage because the claim

was not first made and reported during its policy period, and the 2016 insurer could deny because there was prior knowledge of a potential claim before its first policy inception.[7]

The danger that can result from a change of carriers was illustrated in a recent decision involving an architect's professional liability policy. On the final day of the first policy's term, the insured gave notice to the carrier of a potential claim. However, that claim was rejected by the carrier as deficient because it did not provide the details required by the policy. The insured then gave notice to the second carrier, which disclaimed because the insured had prior knowledge of the potential claim. The district court upheld both disclaimers.[8] In the first decision, the court found that the notice to the first carrier was plainly deficient on its face. In the second decision, the court granted summary judgment to the first carrier for that reason. And, in the third decision, the court granted summary judgment to the second carrier on the ground that the insured clearly had prior knowledge of the potential claim. The court highlighted the problem that can arise from changing carriers with the following conclusion:

> [The insured's assignee] is incorrect in its fundamental premise that one of the two insurance carriers must have a coverage obligation.[9]

This type of problem is exacerbated where, through inadvertence or in an effort to save on premiums, the insured accepts a prior acts exclusion endorsement (sometimes referred to as a "retro date") in the new policy, which is an absolute bar to coverage of prior acts (i.e., regardless of whether the prior knowledge provision is otherwise applicable).[10]

Risk Mitigation

Nevertheless, there are two ways that the risk of a coverage gap from switching claims-made carriers may be minimized.

One is through a standard discovery clause, providing for coverage of an occurrence within the old policy period which may not result in a claim until after the policy has expired. This usually requires that the insured give notice of the occurrence—including requisite particulars—before the old policy expires.[11] The result is that coverage under the old policy may still apply.

The other is through the purchase of an optional extended reporting period endorsement (ERP), also known as a tail, extending coverage under the old policy to future claims made within the tail period if the claims are based on acts which took place during the old policy period.[12] Here, too, the result is that coverage under the old policy may still apply.

Nevertheless, these potential solutions are not necessarily foolproof. For example, the discovery clause might not be useful because a "common problem is the lawyers' failure to read their policies and be aware of the reporting requirement.[[13]] In addition, lawyers often delay reporting a claim in the hope that the claim will be resolved or not be pressed."[14] Furthermore, it is unlikely that an expensive ERP will be purchased inasmuch as the principal reason for the switch in carriers tends to be monetary.

Accordingly, in assessing whether to make a switch it may be worthwhile to consider the issues discussed herein before taking steps that may prove to be penny-wise and pound-foolish.[15]

*The author thanks USI Affinity for its permission to reprint portions of an article which he wrote for the BR Liability Update (July/August 2001), entitled "Look Before You Leap: Risks of Changing Professional Liability Insurers."

Endnotes:

1. R. Mallen, Legal Malpractice: The Law Office Guide To Purchasing Legal Malpractice Insurance §2.28, p. 12 (2015 ed.).

2. Of course, the insured must also comply with all of the other terms and conditions of the applicable insurance contract(s).

3. Id. §2.33, p. 13.

4. See R. Mallen, Legal Malpractice §38.33 (2016 ed.).

5. The relevant date(s) of the applicable policy period and the first policy period may or may not be identical.

6. See also *Checkrite v. Illinois National Ins. Co.*, 95 F. Supp. 2d 180 (S.D.N.Y. 2000) (regarding the potential for a coverage gap even where the consecutive policies are with the same carrier).

7. See generally *Ingalsbe v. Chicago Ins. Co.*, 270 A.D.2d 684, 704 N.Y.S.2d 697 (3d Dep't 2000); *Fogelson v. Home Ins. Co.*, 129 A.D.2d 508, 514 N.Y.S.2d 346 (1st Dep't 1987).

8. *University of Pittsburgh v. Lexington Ins. Co.*, 2016 WL 3963104 (S.D.N.Y. July 21, 2016); *University of Pittsburgh v. Lexington Ins. Co.*, 2016 WL 4991622 (S.D.N.Y. Sept. 16, 2016); *University of Pittsburgh v. Lexington Ins. Co.*, 2016 WL 7174667 (S.D.N.Y. Dec. 8, 2016).

9. 2016 WL 7174667, at *4. A similar conclusion was reached in the cases cited in note 7, supra.

10. A further timing-related issue which may arise is late notice (as opposed to the issues discussed above, involving (1) claims made and reported, (2) prior knowledge, (3) insufficient notice and (4) prior acts). However, late notice has become a less significant issue since the July 2008 amendment to New York Insurance Law §3420(a) which now imposes a prejudice requirement in that context.

11. See A. Windt, Insurance Claims & Disputes §1.7 (6th ed. 2013).

12. Id. §11.5; see generally N.Y.S. Insurance Department Regulation 121, 11 N.Y.C.R.R. §73.

13. And even if the insured is aware of the discovery clause, the notice might be unsuccessful because of a lack of specificity, as in *University of Pittsburgh v. Lexington Ins. Co.*

14. R. Mallen, Legal Malpractice: The Law Office Guide To Purchasing Legal Malpractice Insurance, supra, §2.33, p. 13.

15. See generally A. E. Neuman, Mad Magazine ("What-Me worry?").

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