

**Controlling Legal Malpractice Insurance Costs and
Availability in a Changing Marketplace**

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Lawyers' Professional Liability Insurance Market - Overview

I'm going to ask Paul Ablan to give us an idea of how lawyer malpractice insurance fits as a percentage into the overall property and casualty insurance market.

... Those of us that have been around this industry for some time have a keen interest in finding out just exactly how the Lawyers Professional Indemnity Marketplace fits into the greater insurance marketplace in the United States. Unfortunately, as much as we would like to have that information, as exact as a science, we are as unwilling as

most of our competitors to share our market information, our intelligence about our own size of our market with those of our competitors. So the best we can do I think, is make an estimate. In a word, the lawyers market is a very small portion of the total United States casualty or liability insurance market. Our estimate of the total United States Liability Insurance Marketplace, the size of the market on an annual basis is itself, a bit of an estimation based on what we think is the available surplus or capital in the marketplace today. The size of the liability insurance marketplace, in terms of annual premiums, is essentially a percentage of that. Our estimate today is that the total United States liability insurance marketplace, that would be including for example, workers compensation insurance, automobile liability insurance and so forth, business liability insurance is perhaps in the range of 350 to 600 billion US dollars per year.

Again, to reiterate, the percentage of that market that is simply the lawyers professional marketplace is small. Perhaps 1.25 billion dollars. Again, obviously far less than one percent of that total liability marketplace in the US. So it's very important and very large from the standpoint of those of us who are working in it, either as insurers or reinsurers or brokers. It is, on the whole, quite a small piece.

LPLI Insurers, Who are They?

... Mike Elliott, who writes lawyer malpractice insurance?

... Well in North America there are over 60 insurance companies that write malpractice for attorneys. There's one

grouping of companies that go under the heading of NABRICO National Association for Bar Related Insurance Companies and in the course material I provided, I list them. Many of these companies are single entities that write in specific states. Other NABRICO companies write in several states and the website for NABRICO can give you an indication if they're writing in your area.

In addition to that, I provided another page in the course material called Non-NABRICO Companies and there's a surprising number of companies. Some of them are household names to people, such as Kemper Insurance Company or Hartford Insurance and obviously Lloyds of London. Others are a bit more specialized. Some of the other companies that write this line of business include the Admiral Insurance Company, CNA, St. Paul, SAFECO, the Scottsdale Insurance Company, Royal Surplus Lines. There's some managing general agencies that write a fair amount of this business representing other companies like Shand Morahan. So there's a considerable number of people out there and part of it too is knowing who the players are.

In the insurance industry, an insurance company can be broken down into two groups, most of the time; either an agency insurance company, or a direct writing company. Now most of us are familiar with who an insurance agent is and most insurance in the United States is sold to the public through an insurance agent. The key thing there is the principle of agency. That agent represents an insurance company. He may represent one or two or he may represent several. Technically there's another grouping of

representatives called brokers. Brokers and agents, a lot of times, are bandied about as being similar, but technically a broker represents the policyholder more than the insurance company, even though he may have a certain agency license. Depending upon an attorney's needs, he may want to search out a broker or an insurance agent who specializes in malpractice and errors and omissions. He also may go and look at certain insurance companies who are direct writers. These are companies that sell direct to the client and do not use agents.

Roles of Insurance and Reinsurance

... Jutta Kath, how do insurance and reinsurance fit together?

... Well let me give you a very simple definition of what reinsurance is. It's simply the insurance for the insurance company, which means the insurance company who protects lawyer's malpractice will seek itself, some protection for that. That can be done in various ways. It depends on the kind of risk appetite of an insurance company--whether and to what extent it will seek protection. What it means is that the reinsurer wants to have an understanding of how the insurance carrier writes that risk and from our perspective, we want to know how is the underwriting done, how is claims handling being done. Also, we may have some say in how the pricing of the policy may come out.

To give you an example, a lawyer for law firm may seek a limit of ten million. So you go to the carrier and maybe they have automatic capacity to write up to ten million or only five million and then they get some extra protection to

be able to offer that to a specific law firm. So it's just this kind of this interdependence about these two players that affect the ultimate product.

... In a sense, a reinsurer is a banker for insurance companies, is that right?

... Well we share in the risk. I'm not quite--well, banking, I don't like that term for that purpose. It's not simply extending a kind of a line of credit, it's more than that. We want to understand what the insurance companies do--I think it's a bit more. We really, truly want to share in the risk and hence we want to understand the risk.

Business Cycles in the LPLI Marketplace

... We all know that there are customary business cycles in insurance and the customary business cycles seem not to have happened in this last business cycle. Paul Ablan, how are the business cycles tied to the overall economy?

... It's a difficult question to answer without opening up a macro-economics textbook and believe me, I haven't done that in many years, but I'll do the best that I can. I think that when we talk about the relationship between insurance cycles and the economy, I guess what is a bit bedeviling to most consumers is the notion that we have seen the stock market take quite a beating the past couple of years. There are a lot of people who assume that that is the reason why insurance premiums are on the rise today, quite aside from the World Trade disaster in September, but they assume perhaps that insurance companies have gotten caught in the same investment problems that a number of us as individuals have high tech stocks or investing in even

Fortune 500 companies that have fallen on some difficult times. We watched our own personal portfolios stagnate and some people will assume that that's the problem in the insurance industry.

It really isn't the case. What's important to note is that insurance companies invest premium dollars that they collect for the most part, in fixed incomes. That is to say, in the bond market. The bond market operates a bit differently than the stock market, but we rely on the bond market for the revenues, the increase in our portfolios, not only to pay claims and expenses, but also to pay our shareholders if we're stock companies.

... I'd also just say a couple things just quickly. The difference between a hard market to the insurance company and the soft market is really a handful of characteristics. Some of my colleagues in the next couple of minutes will talk about what has been peculiar about this last cycle, but in general, by way of definition, we define a soft market, in this case, one that lasted quite a while, as having these characteristics. Several insurance companies active in the marketplace, that is to say there is a lot of capacity, a lot of companies that are willing to write insurance and therefore most companies make a lot capital available to the marketplace for that. Like any other supply demand equation, that means that there was, in past years, a good deal of supply of capital in the insurance industry. That supply was plentiful enough to cause declining premium prices for many, many years. The problem is, there are a few other characteristics of the soft market that sooner or

later will lead to a hard market and those are, that costs generally don't fall in direct proportion with premiums. That is to say, we have seen over the past 10, 15 years or any time in history really, claims get more expensive to pay, settlements are relatively higher today than they were last year or the year before. Expenses of salaries for example, are higher than they were. Those costs continue to increase, notwithstanding that insurance companies in the soft market will continue to decrease or cut their rates and have their premiums fall. You see a gap there and sooner or later when that gap is significantly wide enough, profitability for the individual insurance companies will fall and the industry itself, the insurance industry, will become a less attractive place for them or perhaps even a prohibitive place for them to invest their money. So therefore, you see capital flowing out. It's the capital that flows out of the market that causes the hard market cycle. All of that I think, is quite aside from anything that happened on September 11th, but certainly that has had a market impact, in terms of the speed with which the market hardened this time.

"Hard Market" Cycles and Timing

... Jutta, I heard many years ago that the insurance cycle is normally a three year cycle. About two years ago I was at a conference and someone mentioned that we were then in the 13th year of the three year cycle. Could you tell us what the normal hard market cycle is and why it didn't happen after the last hard market in the mid '80s.

... I'm not quite sure whether that's mathematical. I

think what we saw, especially in the lawyer's market, that there were two people coming in as new entrants, as new carriers offering that kind of line. For some reason, companies felt that was an attractive market, I think because we didn't see the kind of traumatic lawsuits or claims in the lawyers area as we would see in other markets, such as medical malpractice.

That has turned, I think, mid year of last year, even prior to September because people felt like exposures are increasing. The kind of deals law firms handle are getting more and more risky and dangerous and intense, especially bigger law firms, I think, have already seen kind of a tightening in the market around mid year of 2001.

The Effect of 9/11 on LPLI

... Mike Elliott, would you give us a bird's eye view on the effect that 9/11 had on lawyer malpractice insurance?

... I think we probably need to step back for a second and first look at, is the impact of 9/11 on reinsurance overall. Since that's happened, particularly for year end and by the way, probably 60 to 65% of all reinsurance programs renew at year end because companies CFOs like to have their reinsurance track with their reporting requirements for the IRS and for various state entities. The average price increase, probably overall, has been between 25% and 50%, depending upon the experience. At year end, we noticed the negotiations were pretty extended and went very late to the 11th or the 11th and a half hour before deals were consummated.

Now we'd seen that trend for higher reinsurance prices and

that had begun about a year ago. 9/11 obviously accelerated that greatly. Workman's comp in the accident health market quite frankly, for reinsurance, went away because of 9/11 and terrorism exclusions are the norm for property coverage. Now getting back to the reinsurers who handle lawyers insurance—reinsurer companies that write lawyers insurance generally speaking, the impact of 9/11 on those reinsurers hasn't been as dramatic. Either they tend to be specialty reinsurers who write more casualty business, which is less likely to be impacted than those underwriters who wrote aviation, who wrote big property lines, or they were divisions within a reinsurance company and their reinsurance portfolios on lawyers has tended to be profitable, or at least not as bad as other lines in the past. So while we're seeing pressure on reinsurance for lawyers programs as they come up, I don't think it's going to be as dramatic as it has been for large property insurance programs for workman's comp, for accidental death and dismemberment policies and that sort of thing.

I think we're going to see pressure from the reinsurers. It may be more from the impact of Enron and things like Kmart than it will be from terrorism.

... So for all our listeners out there, you're telling them there's good news on the horizon relatively speaking.

... Well let's say it's not as bad as it could be if you were trying to reinsure a highrise building in New York or write workman's compensation on companies that have large concentrations of employees that are susceptible to attack.

Effects of a Hard Market on LPLI

... We're going to now talk a little bit about the likely effect of hard market cycle. It seems as though anytime the market hardens, there's some fall out on the lawyer professional liability business. Paul Ablan, could you tell us a little bit about the most likely fall out, which has to do with policy enhancements.

... I think one of the things that is important to note here is some good news with respect to what's likely to happen with the marketplace for Lawyers Professional Indemnity. The message is that the situation with insurance company profitability on their lawyers malpractice books was showing signs of deteriorating over several months in fact, probably better than a year before the World Trade disaster last September. In other words, it is certainly not fair to say that the reason for an increase in lawyer's premiums today is directly the result of the World Trade. World Trade certainly did nothing to help and it has certainly taken capacity out of the marketplace and quite frankly, capacity in the marketplace is a bit fluid.

If a company has less policy limits to offer across all its lines of insurance, then certainly we all have to look at what areas of insurance it wants to remain in . . . you can't really pin any of the World Trade losses on a lawyers malpractice portfolio. A company is forced because of having less capacity available to make some difficult decisions about what lines of insurance they remain in and at what price. So there is an indirect effect between the two.

I think that there was an excellent quote I read a few weeks ago in the press by a member of our industry who said, that when the going gets tough, some insurance companies throw underwriting out the window and give business away. Now that's a bit dramatic, but it's really a discussion of what some people perceive as the behavior that was going on in a soft market, particularly in the lawyers professional business. This person went on to say that the industry has destroyed more capital through mismanagement than terrorists ever did, which I think is kind of an interesting perspective on it. What we mean by that is, in the past several years, carriers have in general, make certain policy enhancements and limits and so forth very available and very attractive for law firms. Just to cite a few examples; writing coverage that puts the cost of defense in the event of a claim, outside the limits of liability, which means if you buy one million dollar limit policy, that one million will be reserved for the payment of the indemnity, the judgment or the settlement. Any costs of investigation, adjusting fees, attorney's fees, witness fees, etcetera would be coverage in addition to that limit of liability. Than enhancement, defense costs outside the limit of liability was freely available in many states during most of the soft market cycles in the United States. In addition, it became very easy for insurance companies because of the sort rates that they pay their reinsurers to offer a reinstated limit. That is to say, a one million dollar policy, which would apply to any one claim, would be two million aggregate meaning that you're essentially buying a

one million policy that would respond to two one million dollar claims, in the event that there was catastrophe. Those reinstated limits were being offered by underwriters in the soft market, either at no additional cost or at a minimal cost. Those are a couple of the enhancements that we are very likely to see go away.

In addition to that, carriers were very willing to offer low deductibles or even no deductibles in certain instances as a means of luring a business in. Finally, underwriters were willing to offer extensions on a lawyer's malpractice policy for any ancillary businesses that the law firm was also involved in. Again, sometimes for no additional premium. I think that those are some of the enhancements that we're going to see disappear and I think already have seen disappear. In addition to those, we will also, I think, begin to see some exclusions creep into policies, either because the reinsurers are no longer willing to provide that accommodation to the primary companies or because the primary companies believe that that are commercially unfeasible in the current marketplace. That will be, for example, you may start seeing more carefully worded exclusions that attempt to exclude claims arising out of lawyers investments in client businesses; or lawyers who choose to take an officer or a director position in a client business; or in fact, claims brought against law firms that are the result of the law firm suing a client for unpaid legal fees. Those are I think, some of the exclusions we're likely to see or maybe are seeing already.

How a Hard Market Affects Cost & Availability

... Jutta, could you briefly tell us, with respect to the anticipated coming of an even harder market, what that will do to the cost, to the availability and to the information sought in applications.

... Yes, certainly. Paul is very right to anticipate certain changes in lawyers policies. What we also look very closely at is the kind of limits that are being offered to the various law firms. These limits will be more expensive. Like for example, if we look very closely whether a company writes primarily the smaller law firms, ten million in automatic capacity may not be available anymore and if so, it certainly will be more expensive.

Just in very general terms with regard to seeking more information, that has been always our practice to see how the actual underwriting process is taking place. How detailed is the risk scrutinized? Quite honestly, I never gave up asking these questions, because sometimes as a kind of a feature of the soft market, we may not always have gotten these answers. I certainly will make an effort to reiterate my question and certainly make sure that I get those answers, because if we don't understand the underlying risk, we cannot seriously and responsibly write that business.

How Lawyers Can Affect Costs

... We're going to talk for a little bit now about what lawyers can do to affect the premium costs. The suspicion is, among those people who follow the industry, that the coming of the harder market is going to result in a price

increases for lawyers. You've heard several of the panelists refer to this and it seems to be sort of a consensus among the insurance professionals, but there are things that lawyers can do to affect cost.

. . . Jutta, could you talk about the effect of cost on the limits buying lower limits or buying higher limits.

... Very simply speaking, a higher limit is more expensive than a lower limit. But before we, a lawyer, a law firm should consider getting a lower limit, I think it's very important to assess what the insurance needs are in the first place. Let me rephrase the question to ask, what is the life limit for a specific law firm? Of course, this question can only be answered on a case by case basis, but let me give you some example what I think should be considered before you decide whatever limit you want to buy. You should consider what kind of risks and financial exposures are handled. What's the structure of the firm? Is it a corporation, a partnership, or is it just a sole law firm. The firm's size also has an impact on the size of limit, as well as the area of practice. Keep in mind that whatever goes wrong, your personal assets are at risk. So look at what's the kind of business that is done, then decide, well does it really cover me for that kind of scenario.

There are other things that go into the pricing and ultimately have impact on what limits should be sold. I already mentioned the size of the firm, but that means not only the lawyers, but also the non-legal employees, that is paralegals and secretaries. The more you have, the more you

may have an exposure in supervising these employees. Of course, things like jurisdiction and the range of service and all of these things should go into the consideration. Also just very generally, you don't want to be the only deep pocket in a scenario for various co-defendants. If you are a solo with the highest limit in a group of some other co-defendants who decided to buy lower limit, you're the targetAnother thing before someone thinks about considering lower limits, first look at what do I really have in my current policy--do you have defense costs outside or inside the limit, which of course means, whatever is out there, in terms of covering a financial disaster, may be impacted by the defense costs? So there might be less available. If you have a policy like that, you have to be more careful. . . .So I think that's very vital to understand the policy in the first place, before you go out and just simply for saving a few bucks, drop the limit.

... Paul Ablan, are there other considerations of what lawyers can do to affect premium costs?

... the issue of whether the deductible that you select, in other words, the amount of risk that you retain, is something that though theoretically can have an impact on what the cost of your ultimate insurance is, I think, an issue that for a smaller law firm and even a mid size firm, may not bring them quite the price relief that you might think. That is to say, if you're a large firm that is carrying a deductible of \$50,000 per claim, you may find that there's a significant cost savings to be realized by doubling that retention to 100,000 or bringing up perhaps to

250,000. From an actuarial standpoint, a shift like that will have a dramatic impact on our expected loss cost in the event of claims. The problem unfortunately for the smaller firm is that they ought not to expect too much of a difference in price from the company's perspective between a \$1,000 deductible and a \$5,000 deductible, even though for a small practitioner or a solo practitioner that can be a considerable additional exposure that they're retaining in their small business.

The other thing I would caution is that underwriters in general are reluctant to allow small firms to retain a high portion of the risk. In other words, I think underwriters recognize that a solo practitioner or a two or three attorney law firm is at the end of the day, a small business and quite a small business and therefore, it probably has no business having a \$50,000 retention. The insurance company's got to wonder in the event of a claim, whether there will be a collection problem of that deductible afterwards. So it can have an impact certainly, but I think that and I have to be sort of towards the size of the firm itself and how much risk is really appropriate for the size of the firm to retain.

Systems of Avoiding Malpractice

... Paul Ablan, Are there systems that guard against malpractice claims and if there are, what are they and how can they help?

... Well there certainly are those systems and I think one of the rather unfortunate things in the past years of the soft market is the reinsurer's abilities to become more

involved and have more input in the decisions that the primary underwriters were making was a bit difficult in a soft market cycle when there was such availability of reinsurance capacity. We in turn, have the same problem with the law firms that we were insuring. That is to say we were loathe to ask too many questions or make too many requirements on the subject of docket and calendar control in firms, for fear that one of our competitors would be willing to write that risk without burdening the law firm with three more pages of application to fill out or with a requirement that over the next year they beef up their systems for conflict avoidance or for docket control and so forth.

I think in a harder market cycle, you should expect that there's going to be more diligence obviously, as I've said earlier on the part of the underwriter. We'll be paying attention to these things. Likewise, primary insurers can expect our reinsurers begin to have much more careful conversations with us about the extent to which we are underwriting loss prevention systems in law firms into our total view of law firm acceptability. A recent study by the American Bar Association on a profile of legal malpractice claims, which is available from the ABA, was published within the last year. That study covered five years from 1996 to 1999 and some interesting things in that study from an insurance company standpoint. The last study that was done in 1995, for the early '90s, showed that 27% of all claims against lawyers were administrative in nature. What we mean by administrative in nature is, they were the result

of a failure in the firm's systems to avoid a loss, whether that was a docket or calendar entry or some other sort of clerical error that was made. Twenty seven percent was certainly significant in 1995. The 1999 study showed a decrease to 16.4%. Now that's a significant decrease, but bear in mind, it's still a great deal of claims that are arising out of what we would consider to be wholly avoidable system failures.

So these are meaningful topics to insurance companies. I'll talk about just a few of them; docket and calendar control which everyone listening to this conference today is familiar with and probably tired of hearing about; conflict of interest avoidance; and policies and procedures in the firm that geared toward investment in client entities and serving as corporate directors and officers, just to name a few. Again, most of us who have filled out an application for professional liability insurance are used to being asked a host of questions about the extent of our loss prevention systems. In the past few years maybe, some of us have gone a little soft on those and I think are starting to beef up and do a better job of requiring the answers to them. But simply put, we are at a stage in the practice law, where it ought to be second nature for a firm to have some fashion of a dual entry calendar control or docket system, whether that sole practitioner or a 500 attorney law firm. That is to say, even if it is not a computerized system and there are so many of those available today, even for sole practitioners. If it's not a computerized system, you eventually need a dual entry system, so that there is a

failsafe in the event that the lawyers own calendar is either lost or a date is neglected to be written there, that it will be written in very simple terms in a secretary's diary as well.

Again, this stuff seems like it should go without saying, but we are surprised that the extent to which we still find in some law firms of rather large size, 10, 15, 20 attorneys that there really isn't a method for watching for dates and deadlines and so forth; or if there is, this is the more important question, if there is such a system in the firm, whether there is a requirement by the management of the firm that that system be used. In other words, we have seen in our own law firm risk surveys and audits that we've done in the past. Excellent computerized docket systems in law firms that we're also found in many occasions that the incidents of use of those systems can be very low in some firms. Money has been spent. The training has been done. Three years later they've got dust on them, because it's just not being used. So the extent to which law firms have these systems and are using those systems and can demonstrate that to the underwriter, I think, is very helpful.

What I mean by demonstrating that to the underwriter is very simply, make it clear that there's a policy in the firm, a written policy in the firm that that system has to be used when a file is open, that calendaring, diarying of dates is something that has to happen in the firm. Let's go on to conflict of interest avoidance. In spite of the fact that we think that administrative errors have declined in

frequency, according to the ABA Study that was released last year, conflict of interest claims have increased. It looks like today, conflict claims are about five percent of all claims that are made. I think that one might even be a little deceiving because anecdotally our experience at the St. Paul is that if a client has a claim against a lawyer, they'll make that claim, but at the same time, if they can find anything about the representation that they think smells of a conflict or a perceived conflict, they will include that as an additional count. I've told people that conflict of interest claims against lawyers are almost boilerplate in today's complaints. That is to say, clients understand, lawyers, plaintiff lawyers understand that juries, this is the sort of thing that gets juries emotional and angry. A concept of the lawyer may be double dipping or not being entirely focused on the needs and the interest of the client. Again, conflict of interest claims are on the increase in the St. Paul data as well and it's something that we are concerned about. We ask the questions on our applications as to most, if not all of our competitors, about whether the law firm has systems in place that will require a lawyer when opening a file, to do a search to ask enough questions of the client at initial consultation to find out who the adverse parties are and related entities, subsidiaries or whatever and check those names against a list of the firms current or past clients. There are again, some tremendous computerized systems that can do that today with the touch of a few buttons. We believe that every firm ought to be availing themselves of some sort of automated

conflict of interest avoidance of systems. And again, on your application form where you have that opportunity, demonstrate to the underwriter that those are things that you do have and that they are the requirement in the firm before a new client is accepted or a new case is accepted.

How Credits and Debits Affect Premiums

... Jutta, could you talk for a little bit about what credits and debits insurers use and how that can affect the premium cost.

... There are some, what I would call, objective factors. For example, the deductible, which we already mentioned, the size and whether the deductible applies to the limit has an impact on the pricing. For example, unwillingness to take a deductible will of course, result in a higher premium. Then there's the firm size. There's the assumption that a midsize small firm may have better controls in place than someone who's totally on his or her own. Another thing which drives the price is the ratio from non-attorney to attorney staff. The more staff you have, the more obligation you have to supervise that staff. So if you have like four secretaries for one attorney, that certainly rings alarm bells and that has impact again. If you attend CLE seminars or other opportunities, that certainly can also lead to a credit. Then the coverage itself, do you buy a retroactive date or not. How much claims activity will stay in the past, depending on how many years spent it goes and also, the size of those claims have an impact. There might be a carrier who offers a no claims bonus and for those attorneys who work on a part-time basis, there might be also

some price cut available. Depending on the geography, also there, it has an impact on the pricing. Then very important and it's something which I think, people should spend time on is the area of practice in not only that, but also the percentage of that in the overall context.

I'm going to give you some examples of debited practice and that varies from carrier to carrier. So this is just one example not kind of a hard rule. Collection, repossession or corporate law, estate and trust always rings an alarm bell and resold in a higher premium. Again, you have to keep in mind, how much of that do you practice. So if it's only like a minimal portion, then that has a different impact. Taxation and SEC law also has more leans towards debits, debiting of the premium.

To give you some examples of credited areas of law is the criminal defense law or immigration law. Then there are some other kind of soft factors that go into the pricing. The total absence of clerical staff doesn't come across well. If you not complete the application or showed in some sloppy form or fashion, that doesn't come across well either. If there's a lack of new client screening that leads to these conflict issues. Also if they're shopping around, and you showed the history of your policy buying and that's certainly something which companies look for. Owning an interest in a client's business is not looked upon favorably.

... Jutta, is it safe to say that if you can make your application look attractive, that you will A, enhance your opportunity to secure insurance and B, get the most

favorable rate?

... Yeah, I think it's safe to say, but on the other hand, it also depends on what the firm is doing. If you totally focus on personal injury plaintiff work, that is seen as an area of law, which is quite on a kind of negative side of things. So as long as that's the case, let's say 100%, no matter how careful you are with the client intake, that's certainly will cost you more than being a defense firm.

Limiting Practice Areas

... Mike Elliott, I'd like for you to bring us up to date on what effect limiting areas of practice might have and whether that's a good idea.

... I think it is. I act as a reinsurance broker for several companies that write lawyers and I get a chance during reinsurance claim reviews to see where their claims come from. It's very surprising, the number of claims that come from attorneys who, when you look at their individual form that they fill out, whether they're a solo practitioner or whether it's that individual questionnaire that each attorney in the firm fills out. If you see an area of "specialization," but the percentage of a particular area is only five or ten percent, it's amazing to me that the number of claims that generate out of that particular sub area. You really should specialize and don't dabble.

Another area to consider also, is don't promise experience that you don't have. I've seen cases where an attorney did nothing wrong in an actual trial, but he intimated to his client when they came to visit him that he was good in a particular area, an area that in reality he had no

experience or very little and they lose the case. The claimant sometimes goes away, thinks about it and contact another attorney and they sue the first attorney for leading them on. So be careful with what you promise, be careful about what you do and specialize in areas that you're good at and you can spend enough time at it to be competent and proficient.

Also, get off outside boards if at all possible and particularly when we see a lot of stocks tanking like Enron and Kmart these days, be careful of any kind of investment advise you give to clients.

Special Advice for Solos

... Now for those members of the audience who are either sole practitioners or not practicing in a large city, what advice could you give them? Certainly clients are coming to them asking for legal services from time to time that they might not be expert in, but because a prior dealing with the client or because of the client's need at that particular moment, they might be in a position where they almost feel that they have to provide some service. Is there any guidance you can help give these individuals with respect to protecting themselves?

... Well I guess my major concern there would be to make sure that the client understands and perhaps you even put it in writing to them, that you don't do that much of a particular area. If it's a matter and I hear what you're saying and obviously, there is a comfort factor in rural situations. People, I think, are a little bit less likely to sue each other, but the key thing is to make the client

understand up front that your capabilities or lack thereof and then if they still wish you to take the case, do it perhaps, but you might want to seek some additional advice from another counselor as well.

The Problem of Gaps in Coverage

... Paul Ablan, could you talk about the problems in coverage gaps when one is changing carriers. What is a coverage gap, how do you identify it and what's the problem with it when one changes from Carrier A to Carrier B for their lawyer malpractice insurance.

... First I'd say as a general statement, the best way to describe the difference between a professional liability policy, which is a claims made policy and a more sort of garden variety type of liability insurance, for example, automobile liability is that within a given policy year, an automobile liability policy premium is paid an accident or loss happens and more often than not statistically, damages paid or liability is at least fixed to a reasonably certain amount, all within the space of a 12 month policy period. What is different about lawyer's malpractice insurance as claims made coverage is that the insurance company is insuring a practice wherein an event, provision of legal service to a client, was accomplished three or five years or even longer ago, but that it didn't ripen in a sense, into an actual claim or the claim didn't become known or the loss didn't become known to the client until five years later. Then we've got a claim and the insurance company gets involved.

A claims made policy, when changing carrier to carrier, does

have the potential of a coverage gap. Claims made insurance is where the carrier who is on risk at the time the claim was made, not when the accident occurred or the act occurred or the omission occurred, but when the claim was made to the law firm, the carrier that is writing the policy at that point generally speaking, will be the carrier that will cover that claim. The issue to bear in mind there is the concept that we use in insurance, in professional liability insurance of prior acts cover, that is to say in the sort of claims made coverage that has been widely available throughout the soft market and still is today, I believe, is what we would call full prior acts cover. That means that the carrier that takes on your firm on the first of January for a 12 month period will—you will report a claim to that carrier that happened, that the claim came into you yesterday. A client had written a letter to you or has served process on you with respect to what they considered to be a mistake or a professional negligence on your part that has caused loss to them. The incidence of your act or omission that they're alleging may have occurred three years ago, but the claim is being made now, let's assume for the purpose of the statute of limitations that they are well within the limit, the statutory limit. So it's proper in that respect. If your claims made policy has full prior acts coverage, then you have no problem with your carrier accepting that claim.

On the other hand, if you changed carriers at the end of last year and going forward on January 1, in a hard market cycle, you have mistakenly or because there wasn't any other

option for you, for whatever reason, purchased a policy with limited prior acts coverage, there are really two types of those. Those that provide no prior acts, we call those policies with inception retroactive dates, which means that the policy will only cover errors and omissions that were made by you from the time that the policy incepted and going forward, so that if the legal services that gave rise to the claim were made six months ago in a different policy, an inception retro claims made policy won't provide any coverage for that.

So when changing carriers, long story short, you've got to be very careful that you know first, what the nature of the prior acts coverage that you have today before you change and then going forward when you're shopping for a new carrier need to find out just exactly how available full prior acts coverage is. If a policy is restricted as to its coverage of prior acts, it will either be, as I said, on an inception basis, which means from the date of a new policy going forward, those are the only legal services for which you'll have cover or there'll be some sort of a retroactive date that won't go back to what we would consider full prior acts. For example, they may only go back three years or they may only go back five years before the inception of the policy.

Sometimes there's an assumption of the risk that a lawyer is willing to take as a business person to say, look, I think that, I don't have a long tail business. In other words, I'm not drafting wills or doing estate handing or anything else that where a mistake I've made could fester for ten or

15 or 20 years and go unnoticed. So perhaps I can take the risk of having a policy that only goes back five years, in terms of prior acts covered, but that's still is a risk that when the claim comes you won't have that cover. Again, in a time when coverages we see are being restricted, enhancements are falling away and prices are going up, if you're changing carriers, you've got to be careful that going forward you have the prior acts coverage that you expect you have, that you had before perhaps, and that in fact you need, given the type of practice you have.

... In following up on that, from time to time a lawyer will report a claim to his or her insurance company and the response will be that gee, you knew about that before you bought the insurance. We don't provide cover for that because any claims that you knew about prior to, that you knew or should have known about prior to purchasing the insurance, the insurance company won't provide cover for. Is there some way that the lawyers can protect themselves against possible gaps in coverage by insurance company that currently provides cover saying, you either knew or should have known about this problem?

... A law firm should have concerns when switching carriers about incidents just like that. I sometimes refer to that as the suicide squeeze, similar to in baseball. What I mean by that is, you've got a situation where out of an abundance of caution, you before you change carriers, you gave notice to your prior carrier of an incident, something that hadn't truly ripened into a claim, nobody's filed a lawsuit against you. You may not even have received a letter or some

communication from the client saying that she was unhappy with the legal work you performed or she thought you'd made a mistake, which cost her money. It may be an acknowledgement on your own part, a discovery on your own part that you have made a mistake. Whether that will ripen into a claim or not, you're not quite sure. Out of an abundance of caution, some lawyers will report that to their carrier and the carrier may say, look we don't think this is ripe enough or current enough yet, to constitute a claim. We aren't going to take any action on it. They may even say in certain circumstances that they do not consider it to be a claim or a circumstance. Three months later when you've changed carriers, even if you have full prior acts coverage, your new carrier, if that incident does in fact truly become a claim and you report it to your new carrier and may somehow come upon knowledge that this is something that you reported to a previous carrier, even if the previous carrier has said, we didn't think it was ripe enough for under our definition of incidents or claim, it didn't meet the requirements. The new carrier going forward may say, you had prior notice of this and therefore, it's not covered under your new policy. That is again, that's a bit of a squeeze that the lawyer finds herself in that you have to be careful about. And I think, couple pieces of advice I'd give you in that regard are, number one, understand very clearly what your responsibilities are in terms of reporting incidents and claims under your old policy, if you're going to change and have that conversation and if necessary, even hire outside counsel if you are really set upon changing

carriers to make certain that you're doing what you can to give proper notice to your expiring insurer, so that the claim will stay where it belongs. Because again, you may find the situation where the next carrier will say, no, you have notice of that or you already reported it and therefore, under our definition of a claim or an incident, this is something that you had prior knowledge of and therefore is not covered. So I think understanding the language of those policies, seeking help from your broker and if necessary, getting an outside legal opinion as to what you should do, because if you find out that you have been squeezed out of coverage, that's a pretty meaningful problem to have and one that would have been well worth an expensive attorney's fees.

Shopping for LPLI

... How aggressive should lawyers be in shopping for a professional liability insurance?

... Very aggressive in today's marketplace, but I'd like to back up for a second and just make one more comment to the coverage gap issue that Paul was addressing. Depending upon the policy with your expiring carrier, and particularly if they're withdrawing from a line of business, you may have the ability to buy from them, an extended reporting cover, which would help make sure that you don't have any gaps in coverage, because it would make them responsible for continuing on for claims made later for incidents that occurred during their watch. So that's something to consider and look into as an alternative, as well as what kind of retro dates you're going to get with your new

carrier.

... You should be aggressive and you should shop for everything, price, service, non-insured items such as risk management services, some companies give advice on docket systems. Financial size is another thing you should look at. There's a system of rating insurance companies called AM Best and take a look at the financial size and capability of an insurance company. It's one thing for them to be willing to pay your claim, it's another thing for them to be able to pay their claims, particularly if there's an unseasonably large number of them.

Select an insurance agent or broker who understands lawyers professional liability business. Don't just go to the guy that sells you your homeowners insurance or your automobile insurance. You're a professional in your line of work, go to another professional. I was talking earlier about not dabbling, well the same thing is true with insurance agents. Don't go to an insurance agent who only dabbles in lawyers professional. You should search out on your own and find the direct writers that are out there also and contact them. Some of them have websites; they have 800 numbers. Ask them for their application forms. You'll be working with a company representative there and you just said, fill it out carefully and completely.

Look at and ask for multiple quotes. Don't be timid about asking them to give you a quote for one million cover, two million cover, three million cover and also bear in mind that lawyers professional insurance is written on a per occurrence and aggregate basis. In other words, there is

one limit for a single incident and there is usually a second limit which essentially is an aggregate limit. So let's say you had one claim that came along for a million dollars and that's what you bought. If you had the claim for a million and all you bought was a million/million. Then your policy is used up and you've either got to go hat in hand to your insurance carrier and ask him for a new one, or you have to find a new insurance carrier. So look at the aggregate limits you're buying as well, whether it's one million/one million or whether you're buying one million/two million, so you get a second bite of the cherry if you have a second loss. Study the policy form, there are differences there too. Make sure what's covered. Are there coverages for disciplinary actions and things like that? Policies vary all over the place and not only for the amount of defense cost inside or outside the limits. So shop aggressively for everything.

Using a Broker

... Assuming that some of our listeners are in a smaller or rural area, how do we go about bonding the brokers who specialize in professional liability insurance?

... Well often times they are divisions within larger insurance operation, such as what we call the ABC houses of the insurance trade, the Marsh McClellans of this world and the Aons of this world. Other times there'll be insurance agents who tend to specialize and who will show up at bar related functions. ABA conferences on malpractice is a good place to look for them. Contact other friends of yours that are attorneys, find out who their agent is. Are they

satisfied with him? Who is their insurance company? Do they like them? Have they had a claim and how was it handled by that insurance company? Was he satisfied with the results there? The network, I guess, is probably the best way I could advise.

Expect and Demand Service

... Paul Ablan, how does one go about looking forward? Mike just identified the provision of good claim service or good service by the insurance company. Is that something that we as lawyers should be looking for and if so, how do we go about looking for it?

... I think it is and I also think that Mike has made my answer here very easy, because he's sort of set it up. I think his comment was excellent. That is to say, if that process begins with choosing the right intermediary, the right agent or broker that will survey the market and get the options for you. I would absolutely echo what Mike said about choosing one that is familiar with several companies, that is perhaps, attends bar related events or insurance industry events that focus on professional liability insurance, so that the agent or broker really has some depth in the area. Because many times that agent or broker is going to be in a tremendous position if they are experienced enough in lawyers insurance, they're going to be in an excellent position to give you a good idea of just exactly what's available in terms of service and what the companies, the various insurance companies' reputations are for claim handling and sometimes even for specific areas of practice. Brokers will tell you if it's an intellectual property firm,

these are the companies that have done the best job of handling those claims or insurance defense or whatever. So I think it begins there certainly.

I think that in addition to that, you should ask your colleagues in your practice area to find out which companies have claim representatives that are sort of local to your area or local to your state, rather than having you deal 1,000 miles away with an adjustor in the event that there is a loss or an allegation. Certainly, the experience that the carrier has in handling the claims, let's face it, you buy this coverage primarily to protect you and to pay on your behalf in the event that you've been accused of professional negligence and therefore, what you're buying is the ability of an insurance company through their claim handling protocols to keep you in practice and keep your business operating so that it should be very meaningful. So it should be relevant to you just how long a carrier has been involved in this type of claims and it's certainly okay to ask that question, whether they're new to the market.

The fact that they're new to the market certainly isn't fatal, because the next question you should ask then is, all right, tell me about the experience of the people that are handling the claims. It's a question you're allowed to ask as well to find out whether the right sort of experience exists in that company to handle the claim. I think the reputation of the insurance company certainly is meaningful and something that by word of mouth in the industry or in your profession, something that you should be able to learn about as well. It is certainly something that requires some

investigation and I'm not a person who says that you shouldn't necessarily take the lowest price out there, in terms of lawyers professional coverage. What I am saying though is, if you are going to take the lowest price, work with your agent or broker to understand just exactly what you're getting for that price and what to expect so that you won't be surprised when the claim does come.

Frequently Asked Questions

... Jutta, one question for you. Do reinsurance companies like to have long, ongoing relations with the primary companies or do you find that you enter into different treaties year after year with the primary companies?

... I can only speak for our company. To have a long standing relationship, because I think that allows us to really understand what the business is all about and to go into all sorts of aspects, all for what the primary carrier is doing. I can tell you from my own practice that we would go into the company, talk to claims handling personnel, also talk about the underwriting approach and risk management. These kind of things you only learn over time and this just takes time -- just to jump in and out from one year to the other doesn't make things. So that's not our approach.

Cut-Through Endorsements

... Could you tell us what a cut through endorsement is; whether those are important; and whether they're normally part of the insurance contracts?

... Well legally speaking, our contractual relationship is with the insurance company. So when you talk about a cut through, this is the intent of the original insured, i.e.,

that law firm or the individual lawyers, to go after the reinsurance carrier. That's something which we don't like, because we look at where is the privity of contract and hence we go along those ways. Cut through is certainly something I look after very carefully (chuckle) and avoid it.

Widening Gap Between Preferred/Non-Preferred Risk

... We're a retail broker, we notice in New York that the preferred risks, even though everyone's getting an increase, preferred and non-preferred risks. The preferred risks seem to be getting a way better deal now than the non-preferred risks. I wondered if the panelists can address, is that a trend either nationally or long term where we'll see the gap between preferred and non-preferred to continue to grow, as opposed to five or ten years ago.

... Mike Elliott, would you like to take a stab at that?

... Well it would be, number one, the reinsurers that that insurance companies look for, two things. They want stability . . . reinsurers don't jump around, but they still want their price increase. So they'll put pressure on the insurance carrier to get an overall rate increase. Now they're also putting pressure on that same insurance carrier to have a good loss ratio. Generally speaking, this tends to mean that the surcharge structures of the company institutes during a hard market, will tend to go after the non-preferred account because it's only natural that an insurance company wants to keep as many of its renewals of what they consider their better business intact, because it's more cost effective and to apply the rate surcharges to

either areas of practice or firms that have not had as good a track record or who perhaps, don't have risk control capabilities. So I would say the preferred risks gap will continue to widen.

Continuity of Relationship with Carrier

... I think the panel has done a good job of bringing to the surface a lot of things that lawyers should consider. One of the things I wanted you to touch on as part of our retail operation, what we've done on a consistent basis is really preach continuity in building a relationship with the carrier and how important that is. I think the key in terms of marketing the risk, is keeping the carrier on their toes and looking for the best product, the best price out there, but I do want you to touch on the benefit of building a relationship with a carrier.

... Paul, would you like to take a stab at that and you might also chronicle some of the insurance companies that have been buried within the last several years.

... Well there have been a few, certainly. The positive about that is that it's part of the unfortunate situation that carriers have come and gone in this line of business. A lot of the talent, a lot of the underwriting and claim handling talent that has been in one carrier has gone to another carrier. So it tends to be a bit of a cozy industry and that I think, to some extent is good in the sense, even if one company isn't in business anymore, you might find the expertise through the experience, either on claims or underwriting is existing someplace else. To answer the question more directly, yeah, I think continuity is very

important.

I think it becomes more important on larger claims. At the end of the day, as underwriters for stock insurance companies, our job is to produce an acceptable rate of return for the shareholders. In order to do that, we have to look at profitability to the best extent we can, on an individual policy by policy basis, which means that we look, sometimes very simply, at how much premium we've received for a law firm over the total history of our insuring them and the amount of money that that firm has cost, in terms of either claim expenses or indemnities or either through settlement or through judgment. It's a bit of a mathematical equation and obviously, the longer the firm has been with the carrier, the more premium they paid over the years, the more familiarity there is between the broker and the underwriter or sometimes even the law firm and the underwriter. I think the better the relationship and when there is a big claim the happens and a carrier is forced to pay out perhaps several hundred thousand or millions of dollars, it is helpful, I think, to the future of that law firm, to stay with that carrier that you can look back on a five or ten year experience with the same carrier, where the claim experience has been very stable, very acceptable and therefore, I think that the carrier will be more often than not, willing to keep that insured on the books, notwithstanding one very difficult loss. Again, because of the relationship. That will become a more difficult thing to do as the market softens and prices start to fall again, because the carrier may have in its mind that

the risk still needs a rate commensurate with the higher level of exposure than the market may think at that point, but that's the problem with a soft market. But yes, I certainly agree that continuity is very important.

Lloyds Market

... Have recent events had any unusual impact on the Lloyds market, so that firms insured in Lloyds may be facing increases of issues different than firms insured elsewhere?

... Mike Elliott and Jutta Kath, why don't you all provide an answer for that one.

... I think it depends. Lloyds is not a single entity. You really should think of Lloyds as much like the New York Stock Exchange. It is a center for—and a capability for many syndicates backed by either individual names or corporate capital to write business. So within Lloyds, there are syndicates who specialize in property insurance and there are syndicates who specialize in health insurance. There are syndicates who specialize in aviation. There are syndicates that specialize in professional liability or general liability business. It depends upon which Lloyds syndicate got tapped by 9/11. Generally speaking, the reinsurers at Lloyds who tend to reinsure lawyers and other types of professional liability are not the same syndicates who were involved and took heavy losses in September 11th.

Now there's fall off from it, because they may be part of a larger operation that has more than one syndicate and it may affect them in future years. But generally speaking, the impact if Lloyds is no different, I think then the impact of other American insurance companies who have divisions that

write property and who have divisions that write professional liability.

... Jutta, is there anything you'd like to add?

... I fully agree with what Mike has said. One thing, it really isn't a question of specialties. Casualty business in general has been looked upon very critically over the past year, so I think it's important to know who is the exact syndicate who is behind, who is backing the law firm. But coverage should be available as well.

... Unfortunately we've run out of time. I hope that you found today's program informative and enlightening.

... On behalf of the Standing Committee on Lawyers Professional Liability and the ABA Center for Continuing Legal Education, thank you speakers and callers for participating in today's program.